IASB Update

From the International Accounting Standards Board

January 2012

Welcome to IASB Update

The IASB met in public over three days, starting on Wednesday 25 January. The FASB joined the meeting, via video link, to discuss Financial instruments: Classification and Measurement and Financial instruments: Impairment.

The full list of topics for discussion at the joint IASB/FASB meeting was:

- Financial instruments: Classification and Measurement
- Financial instruments: Impairment

The topics discussed at the IASB meeting were:

- Agenda consultation—comment letter summary
- Effective dates of IFRS 10, 11 and 12
- IFRS 1 comment letter analysis
- Insurance contracts: education session
- Macro hedge accounting
- Matters to report to the Board from the Interpretations Committee
- Work plan

The IFRS Advisory Council is meeting in London on Monday 20 and Tuesday 21 February. It is a public meeting. A recording of the plenary sessions will be available on the IFRS website shortly after the meeting has concluded.

The next public meeting of the IASB will be held in the week of 27 February

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Future Board meetings

The IASB meets at least once a month for up to five days.

The next Board meetings in 2012 are:

27-29 February
19-23 March

To see all Board meetings for 2012, **click here**.

Archive of IASB *Update* Newsletter

Click here for archived copies of past issues of IASB *Update* on the IASB website.

Podcast summaries

To listen to a short Board meeting audio summary (podcast) of previous

Board meetings, **click here**.

IASB/FASB sessions

Financial instruments: Classification and Measurement

The boards discussed whether they should try to reduce differences between their respective models for the classification and measurement of financial instruments.

The boards decided to jointly redeliberate selected aspects of their classification and measurement models to seek to reduce key differences. The boards decided to discuss the following differences:

1. the contractual cash flow characteristics of an instrument;
2. the need for bifurcation of financial assets and if pursued, the basis for bifurcation;
3. the basis for and scope of a possible third classification category (debt instruments measured at fair value through other comprehensive income); and
4. any knock-on effects from the above (for example, disclosures or the model for financial liabilities in the light of the financial asset decisions).

The boards tentatively plan to discuss each issue jointly and what changes, if any, they would propose to make to their separate models and incorporate in their respective exposure drafts.

Thirteen IASB members voted in favour of the decision with one member supporting a wider review. All FASB members voted in favour of the decision.

Financial instruments: Impairment

The boards discussed how the three-category (or 'bucket') impairment model should be applied to purchased financial assets with an explicit expectation of credit losses at acquisition. In addition, the boards discussed other aspects of the accounting for such purchased financial assets.

Application of the impairment model

Unlike the approach for all other originated and purchased financial assets, purchased financial assets with an explicit expectation of credit losses at acquisition would not be included in Bucket 1 at acquisition. That is, purchased financial assets with an explicit expectation of credit losses at acquisition would be included initially in Bucket 2 or 3.

For these purchased financial assets, no impairment loss would be recognised on acquisition. The purchase discount would be accreted from the purchase price to the expected cash flows. Any subsequent unfavourable change in expected cash flows would be recognised as an impairment loss on the basis of *changes in* expected lifetime loss from period to period.

All IASB members and FASB members agreed.

Scope

The boards discussed the scope of purchased financial assets that would be initially included in Bucket 2 or Bucket 3 and for which accretion from the purchase price to the expected cash flows would be required. The staff asked the boards for direction on whether 'purchased financial assets with an explicit expectation of credit losses at acquisition' was intended to capture the same population of purchased financial assets within the scope of existing IFRSs and/or U.S. GAAP standards under which accretion to expected cash flows is currently required.

The IASB asked the IASB staff to proceed with keeping the scope similar to the scope of existing IFRSs. However, the FASB requested the FASB staff to also explore an approach whereby the scope of purchased financial assets would include assets that, since origination, have experienced a more than insignificant deterioration in credit quality and for which it is at least reasonably possible that all or some of the contractual cash flows may not be collected.

Favourable changes in expectations subsequent to acquisition

The boards discussed the accounting for favourable changes in expectations regarding collectibility of cash flows subsequent to acquisition. The boards tentatively decided that, for purchased financial assets with an explicit expectation of credit losses, favourable changes in cash flows expected to be collected would be recognised immediately in profit or loss as an adjustment to the impairment expense. This is the case even if such changes exceeded the amount of impairment losses recognised by the acquiring entity in previous periods or the amount of the allowance for credit losses.

Nine IASB members and seven FASB members agreed.

Presentation in the statement of financial position of purchased financial assets with an explicit expectation of credit losses at acquisition

The boards tentatively decided that purchased financial assets with an explicit expectation of credit losses would be presented in the statement of financial position at the transaction price without presentation of an allowance for expected contractual cash shortfalls that are implicit in the purchase price. However, disclosure would be required of the expected contractual cash shortfalls that are implicit in the purchase price. The boards instructed the staff to design and evaluate appropriate types of disclosure to facilitate analysis and comparability of originated and acquired portfolios. This disclosure might include discrete information for acquired portfolios that allows users to reconcile from the 'gross' amounts of contractual cash flows, excluding the discount not attributable to credit, to the net carrying amount.

All IASB members and FASB members agreed.

IASB sessions

Agenda consultation—comment letter summary

The IASB discussed the staff's summary of feedback received in response to the Board's Request for Views *Agenda Consultation* 2011, which was published in July 2011 with comments due by 30 November 2011.

The feedback reported to the Board was developed on the basis of the 245 comment letters received, the results of an on-line survey of investors and feedback received from outreach activities undertaken by Board members and staff members.

The staff did not make any recommendations and the Board was not asked to make any technical decisions. The Board noted that these papers would also be presented to the IFRS Advisory Council in February. The Board requested that the staff should do further research to clarify some matters raised in the comment letters and suggested further ways in which the priorities for standards-level projects could be assessed. The Board expects to discuss a development plan in March.

Effective dates of IFRS 10, 11 and 12

The Board considered whether to defer the 1 January 2013 effective date of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* ('the new standards'), in response to a request by the European Financial Reporting Advisory Group (EFRAG).

The Board considered EFRAG's arguments for deferring the effective date and acknowledged the concerns raised by some European constituents. However, the Board also noted that some entities, including European entities, have already committed resources to implementing the new standards and have requested that the original effective date should be retained. The Board gave particular weight to the fact that the new standards, particularly IFRS 10 and IFRS 12, are part of the response to the financial crisis and address matters raised by the G20 and Financial Stability Board.

After considering these arguments, the Board voted to retain the mandatory 1 January 2013 effective date of the new standards. All Board members agreed.

IFRS 1 comment letter analysis

The IASB deliberated on the comments received on the exposure draft *Government Loans* (Proposed amendments to IFRS 1) published in October 2011. This exposure draft proposed to add an exception to the retrospective application of IFRSs to require first-time adopters of IFRSs to apply the requirements in paragraph 10A of IAS 20 prospectively unless the information needed to apply these requirements retrospectively to a government loan as a result of a past transaction was obtained at the time of initially accounting for that loan.

In order to respond to concerns raised from comment letters and to make the Board's intention clear, the Board agreed to limit the scope of the proposed exemption to matters of recognition and measurement, ie a first-time adopter of IFRSs will be required to apply IAS 32 *Financial Instruments: Presentation to classify the loan as debt or equity*. The Board asked the staff to modify the proposed illustrative example to illustrate this point.

The Board also agreed that the amendment should have an effective date of 1 January 2013, with early application permitted.

The Board expect to issue the amendment in February 2012.

Insurance contracts: education session

The IASB continued its discussion on insurance contracts by holding an education session to discuss:

- the eligibility criteria for applying the premium allocation approach;
- whether discounting and accretion of interest should be required for the liability for remaining coverage; and
- the treatment of acquisition costs.

The Board asked the staff to prepare a short supplement to agenda paper 2A outlining a proposal for eligibility criteria that would:

- state a principle that the premium allocation approach could be used when the results would be similar to those produced by using the building block approach;
- permit contracts that have a coverage period of approximately twelve months or less to be eligible for the premium allocation approach; and
- Provide application guidance on when the premium allocation approach and the building block approach would produce similar results based on the criteria being developed by the staff in agenda paper 2A.

Because this was an education session, no decisions were made.

Next steps

The IASB will continue its discussion on insurance contracts (including the premium allocation approach) together with the FASB in the week beginning 27 February 2012.

Macro hedge accounting

As part of its deliberations on macro hedge accounting, the IASB discussed possible accounting approaches for the interest rate risk of closed portfolios of debt instruments. This relates to step 4 of the valuation of the risk position, which is part of the 11 step overview presented at the November 2011 meeting. Today's portfolio fair value hedge accounting approach for interest rate risk in accordance with IAS 39 was compared with a net portfolio valuation as well as with 'bottom layer' approaches for accounting purposes.

In addition, implications resulting from open portfolios (step 5) were considered including the implications of non-homogeneous portfolios for layer approaches (step 6).

The Board will continue its discussion at future meetings.

No decisions were made.

Matters to report to the Board from the Interpretations Committee

IFRS 3 *Business Combinations*—business combinations involving newly formed entities: factors affecting the identification of the acquirer and business combinations under common control

The IASB reviewed issues that had been discussed by the IFRS Interpretations Committee relating to requests for guidance on the circumstances or factors that are relevant when identifying an acquirer in a business combination under IFRS 3 and on accounting for business combinations between entities under common control. The IASB agreed with the Interpretations Committee that these issues would be best considered within the context of a broader project on accounting for common control transactions, if the IASB addresses this project at a later stage.

All IASB members were in favour of this decision.

Annual improvements

IAS 7 Statement of Cash Flows*—classification of business combination cash flows and classification of cash flows for service concession arrangements*

The IASB discussed two different issues that had been considered by the IFRS Interpretations Committee regarding the classification under IAS 7 *Statement of Cash Flows*:

- classification of cash payments for deferred and contingent consideration arising from a business combination within the scope of IFRS 3 *Business Combinations*; and
- classification of cash flows for an operator in a service concession arrangement within the scope of IFRIC 12 *Service Concession Arrangements*

The Board decided that before it could decide on whether or not these issues should be addressed through the annual improvements project, it would direct the staff to ask the Committee to look collectively at these two issues, as well as all of the previous IAS 7 issues that the Committee has discussed regarding the classification of cash flows and consider whether these issues could be dealt with collectively.

All IASB members were in favour of this decision.

Work plan

The work plan has been updated to reflect recently issued amendments and exposure drafts, and the closing of comment periods. It will be available on the IASB website in the week beginning 6 February.

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