BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

May 2009

IASB Update *is published as a convenience for the Board's constituents. All conclusions reported are tentative and may be changed or modified at future Board meetings.*

Decisions become final only after completion of a formal ballot to issue a Standard or Interpretation or to publish an exposure draft.

The International Accounting Standards Board met in London on 5 May for an educational session on financial instruments and on 18-21 May, when it discussed:

- Global financial crisis
- Conceptual framework
- Financial instruments with characteristics of equity
- First-time adoption of IFRSs
- Insurance contracts
- Joint ventures
- Leases
- Post-employment benefits
- Rate-regulated activities
- Revenue recognition
- Annual improvements

Global financial crisis

The Board discussed consolidation, various aspects of its work on financial instruments and credit risk in the measurement of liabilities.

Consolidation

The Board discussed an overview of the responses to ED10 *Consolidated Financial Statements* and the project plan. The staff will work towards an IFRS by the end of the year and at a future meeting the Board will discuss the timing for completing the project. The session was educational and the Board made no decisions.

Financial instruments: recognition and measurement

The Board continued its discussion aimed at replacing IAS 39 *Financial Instruments: Recognition and Measurement*. The discussion centred on classification criteria and impairment.

Classification criteria

At the March joint meeting, the Board and the US Financial Accounting Standards Board (FASB) decided tentatively to consider three potential measurement methods for financial instruments:

- fair value - as defined in FASB Statement 157 *Fair Value Measurements* and as will be defined in the forthcoming IASB exposure draft on fair value measurements,
- another remeasurement method (discussed at an education session on 5 May, at which no decisions were made); and
- amortised cost.

At this meeting, the Board adopted a working premise to proceed with a two measurement category approach that would measure financial instruments at either:

- fair value; or
- amortised cost.

The Board decided tentatively to use as a starting point the classification approach for financial instruments in the forthcoming IFRS for small and medium-sized entities (SMEs). This approach distinguishes between:

- basic financial instruments that qualify for amortised cost measurement; and
- other financial instruments that are measured at fair value.

The Board indicated that under this working premise it would:

- retain a fair value option so that entities could elect to measure at fair value financial instruments that qualify for amortised cost measurement if, for example, fair value better reflects the entity's business purpose for holding the instrument. The Board did not discuss whether to constrain the use of the option.
- prohibit reclassifications between the fair value and amortised cost categories.
- allow presentation of fair value changes for particular financial instruments in other comprehensive income, but without any subsequent transfers to profit or loss (either on disposal or otherwise. This would eliminate the need to test these instruments for impairment.
- eliminate existing 'tainting' rules that limit the further use of amortised cost after disposal of other financial instruments measured at amortised cost. Instead, entities would be required to present separately gains and losses on such disposals.

The Board set a timetable that calls for the publication for public comment of an exposure draft on the classification and measurement of financial instruments by July 2009 and issue a standard in time for 2009 year-end financial statements.

That exposure draft will not deal with hedge accounting, which the Board intends to address in a separate exposure draft to follow shortly thereafter before the end of this year.

Impairment of financial assets

The Board held an educational session on the impairment of financial assets under an amortised cost measurement method, discussing the following approaches to impairment, without seeking decisions:

- expected loss;
- incurred loss; and
- fair value.

The staff provided a summary of the outcome of various meetings held with interested parties to discuss the features and operationality of an expected loss approach to impairment. The staff indicated that, in the light of those discussions, both the Board and those

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Website: www.iasb.org
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ISSN 1474-2675

parties would benefit from a wider consultation before the Board considers making any proposals. The staff also noted that two further educational sessions will be held at the IASB meeting on 15-19 June, at which a large bank will discuss how it would operationalise an expected loss approach to impairment, and the Bank of Spain will present its statistical provisioning model.

The Board decided tentatively that, following the education session in June, it would ask for views from interested parties by way of a website posting. The Board plans to publish proposals on the impairment of financial assets in October 2009, including consideration of an expected loss model.

Credit risk in the measurement of liabilities

The Board discussed a staff draft of a discussion paper dealing with the role of credit risk in current measurements of liabilities. In December 2008, the Board concluded that this was a cross-cutting issue that affected many topics and directed the staff to prepare a discussion document. At this meeting, the Board directed the staff to finalise the draft as a staff document with an IASB wraparound seeking comments.

Conceptual Framework

The Board decided tentatively that the comment period for the forthcoming exposure draft of the Reporting Entity chapter will be 120 days.

Financial instruments with characteristics of equity

The Board published the discussion paper *Financial Instruments with Characteristics of Equity* in February 2008. In October the Board decided to begin deliberations using the principles underlying the perpetual and basic ownership approaches. At this meeting, the Board continued to discuss an approach for determining whether a financial instrument should be classified as equity.

The Board expressed support for a set of draft principles to distinguish between equity and non-equity instruments and a related set of decision rules to operationalise those principles. The principles are as follows:

1. An equity instrument is always subordinated to all liability instruments but may be senior to other classes of equity.
2. An instrument is equity if the issuer cannot be required to settle it unless the issuer winds up its operations and distributes all of its remaining assets. (That is a sufficient but not necessary condition for equity classification.)
3. If a settlement requirement becomes effective when the holder has died, retired, resigned or otherwise ceased to take an interest in the activities of the entity, that requirement does not cause an instrument to be classified as a liability if the holder was required to hold the instrument in order to transact with the entity or otherwise engage in the activities of the entity.
4. Settlement requirements other than those described in item (3) indicate that an instrument is a liability or a liability-equity hybrid instrument (part equity and part liability).
5. An instrument should be separated into liability and equity components if the instrument has two separate or alternative outcomes, one of which would require equity classification if it were the only outcome and one of which would require liability classification if it were the only outcome.
6. Claims to percentages of remaining assets are neither necessary nor sufficient to identify an equity instrument. However, they may help to classify otherwise borderline instruments.

The decision rules to produce results consistent with the principles are as follows:

1. An entity must classify as equity retained earnings and capital contributed without the contributor receiving a claim against the entity in exchange even if that entity has issued no equity instruments.
2. An issuer must classify an instrument as a liability if the instrument has a fixed settlement date or must be settled on the occurrence of an event that is certain to occur, excluding those described in item 3(a) and 3(b) below.
3. An issuer must classify the following instruments as equity:
   (a) instruments that the issuer cannot be required to settle before winding up its operations and distributing all of its assets, regardless of the amount of the claim.
   (b) instruments that the holder is required to own in order to do business with, or otherwise actively engage in activities of, the issuer and are redeemable only if the holder dies, retires, resigns or otherwise ceases to actively engage in the activities of the issuer. This would include holdings, the amounts of which vary according to the volume of business transacted by the holder.
4. An instrument should be separated into liability and equity components if the instrument has two separate or alternative outcomes, one of which would require equity classification if it were the only outcome and one of which would require liability classification if it were the only outcome.

Next steps

The Board will continue to refine the principles in future meetings. For example, one of the concerns expressed was the classification of preference shares that are convertible (either mandatorily or at the option of the holder) into ordinary shares. The Board also will discuss measurement of equity instruments and hybrid instruments with equity components.

First-time adoption of IFRSs

The Board published the Exposure Draft *Additional Exemptions for First-time Adopters: Proposed amendments to IFRS 1* in September 2008. The Board considered the comments received on the ED proposals for oil and gas assets in April 2009. At this meeting, the Board discussed the comments received on the remaining proposals and decided tentatively:

- that the proposed exemption for operations subject to rate regulation should apply to operations within the scope of the Board's project on rate-regulated activities (see separate article below).
- to defer finalising that exemption pending deliberations on the rate-regulated activities project. The Board will consider transition and first-time adoption for that project in

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June 2009, in the light of comments received on this ED and the following tentative decisions.

- that the exemption for operations subject to rate-regulation should also apply to qualifying intangible assets.
- that use of that exemption should not require an entity to demonstrate that other alternatives are impracticable.
- that an entity may use either the proposed exemption for operations subject to rate regulation or the existing exemption for borrowing costs, but not both.
- that the exemption from determining whether an arrangement contains a lease should apply whether the previous GAAP standard was applied prospectively or retrospectively. Consequently, entities would asses all leases once – either in accordance with previous GAAP or at the date of transition to IFRSs.
- to clarify that the exemption from determining whether an arrangement contains a lease would require that application of previous GAAP produced the same result as IFRS, rather than requiring the words of the standards to be identical.

The Board considered other matters raised in the comments on the ED and referred several of them to be considered in other projects.

The Board directed the staff to commence drafting final amendments to IFRS 1 to address the issues dealing with oil and gas assets and leases.

Insurance contracts

The Board continued its discussion of how an insurer should measure its insurance contracts and decided tentatively:

- that the measurement should include the expected (ie probability-weighted) cash flows (future premiums and other cash flows resulting from those premiums, eg benefits and claims) resulting from those contracts, including those cash flows whose amount or timing depends on whether policyholders exercise options in the contracts.
- that to identify the boundary between existing contracts and new contracts, the starting point would be to consider whether the insurer can cancel the contract or change its the pricing or other terms. The staff will develop more specific proposals for identifying the boundary.

In June, the Board will continue its discussion of the candidate measurement approaches for insurance contracts.

Joint ventures

The Board continued its discussion of responses to ED 9 *Joint Arrangements* and decided tentatively:

- to replace the term 'shared decision-making' by 'joint control' for all types of joint arrangement.
- to merge 'joint operations' and 'joint assets' into a single type of joint arrangement called 'joint operation'.
- that, for a joint arrangement established in a separate entity, it is necessary to consider all relevant facts and circumstances to assess whether the arrangement is a joint operation or a joint venture. There should not be a rebuttable presumption that the arrangement is a joint venture.

The Board also had a preliminary discussion about how participants in a joint arrangement should account for their interest in the arrangement if they do not have joint control. The Board reached no decisions on this issue.

The Board will continue its discussion at future meetings, with the aim of publishing an IFRS in the third quarter of 2009.

Leases

The discussion paper *Leases: Preliminary Views*, published in March 2009, deals mainly with accounting by lessees. It proposes that lessees should use a right-of-use accounting model. At this meeting, the Board discussed how to apply such a model in the financial statements of lessors. The Board decided tentatively to develop an approach whereby the lessor retains the leased item in its statement of financial position and recognises:

- an asset for its right to receive rental payments from the lessee; and
- a liability for its performance obligations under the lease.

The Board will continue its discussion of the lessor model in future meetings.

Post-employment benefits

The Board continued its discussion on post-employment benefits and decided tentatively:

- to align the disclosure requirements for post-employment benefits with those in IFRS 4 *Insurance Contracts* and IFRS 7 *Financial Instruments: Disclosures*.
- to require additional disclosures for participants in multi-employer plans.
- not to include in IAS 19 guidance on materiality for disclosures.
- to delete from IAS 19 the references to curtailments and settlements. Other changes proposed in this project would remove the need to distinguish curtailments from negative past service cost and settlements from other remeasurements.
- to require disclosure of the effect of plan amendments, with a narrative description of the amendments.
- to require disclosure of non-routine settlements, defined using wording similar to that used in *IFRIC Update* in May 2008 (events not covered by the actuarial assumptions).

The Board will continue its discussion in July, with a view to publishing an exposure draft in the fourth quarter of 2009.

Rate-regulated activities

The Board continued its discussion of regulatory assets and liabilities and decided tentatively:

- that the discount rate to be used in measuring regulatory assets and regulatory liabilities should be determined on the same basis as in IAS 36 *Impairment of Assets* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*
- that an entity should recognise a regulatory asset for all identifiable costs of self-constructed assets the regulator specifically permits in the determination of rates.
- on general disclosure principles, and on minimum disclosures to be required to meet those principles.
- that some of the required numerical disclosures should be presented in tabular format unless another format is more appropriate.

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The Board directed the staff to draft an exposure draft for ballot. The Board will consider at a future meeting the remaining issues, including transition and first-time adoption.

Revenue recognition

The Board discussed how an entity should account for:

- an option to renew goods and services promised in a contract
- the effects of the customer's credit risk
- uncertain consideration.

Renewal options

The Board decided tentatively that a renewal option should be accounted for as a performance obligation if the stand-alone selling price of that option can be determined without undue cost. Some of the consideration would be allocated to the option and recognised as revenue when the obligation is satisfied.

The staff will consider further how an entity should account for a renewal option if the stand-alone selling price of an option cannot be determined without undue cost. In particular, the staff will explore how an approach of 'looking through' the option (by including within the recognised contract amount the optional goods and services the customer is expected to obtain) would differ from an approach that directly estimates the stand-alone selling price of the renewal option or the intrinsic value of the option.

The Board did not discuss how to account for other options, eg options for additional goods and services as in a customer loyalty programme. However, it decided tentatively that the accounting for such options should be the same as for renewal options.

Customer's credit risk

The Board decided tentatively:

- that the measurement of an entity's net contract position should reflect the customer's credit risk. Hence, uncertainty of collectibility because of the customer's credit risk would affect the *amount* of profit or loss recognised when a performance obligation is satisfied, rather than *whether* profit or loss is recognised.
- an entity should report in the financial statements the invoiced amount of the consideration (ie excluding adjustments for the effects of credit risk) allocated to satisfied performance obligations. The staff will consider further how the effects of the customer's credit risk should be presented in the statement of comprehensive income and disclosed.

Uncertain consideration

At a joint session with the FASB, the Board discussed how an entity would measure its net contract position and revenue when the customer promises an uncertain (variable) amount of consideration.

The IASB and FASB previously decided tentatively that when the amount of consideration is uncertain (variable), the amount allocated to performance obligations would be the entity's probability-weighted estimate of total consideration. However, the boards did not agree on whether, and if so when, the amount recognised as revenue should be constrained.

At this meeting, the boards tentatively decided that revenue recognition should be constrained only if the consideration amount cannot be reliably estimated. The staff will develop proposed application guidance on this point. The staff will also develop potential disclosures that an entity might provide about contracts with uncertain consideration and the estimates used in the financial statements.

Next steps

In June, the Board will continue its discussion of contract-related issues and discuss what amounts an entity should recognise as revenue when other parties are involved in providing goods and services to the entity's customer.

Annual improvements

The Board discussed topics on interim financial reporting and business combinations, for possible inclusion in the exposure draft of annual improvements, for publication in August 2009.

Interim financial reporting

In February 2009, the Board decided tentatively to develop an amendment to IAS 34 *Interim Financial Reporting* that emphasises the existing disclosure principles in IAS 34. At this meeting, the Board discussed the proposed amendment and decided tentatively to include it in the exposure draft.

Business combinations

The Board considered questions that have arisen relating to IFRS 3 *Business Combinations* and IAS 27 *Consolidated and Separate Financial Statements* and decided tentatively to clarify in the annual improvements project:

- that the consequential amendments made by IAS 27 to IAS 21, IAS 28 and IAS 31 should be applied prospectively. However, there is no need to clarify the consequential amendments made by IFRS 3 because IFRS 3 clearly requires prospective application.
- that the financial instruments standards (IFRS 7, IAS 32 and IAS 39) do not apply to contingent consideration arising from a business combination whose acquisition date preceded the application of the revised IFRS 3.
- that in applying IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, an entity classifies an associate or a jointly controlled entity as held for sale when it is highly probable that the entity will lose joint control or significant influence. However, classification as held for sale is not appropriate when it is highly probable that the entity will derecognise the investment on gaining control, because in that case there is no sale of the investment.

The Board decided tentatively that there is no need to clarify the following points, because the relevant requirements are clear:

- The amended IAS 27 requires that total comprehensive income is attributed to the owners of the parent and to the non-controlling interest (NCI) even if this results in the NCI having a deficit balance. The standard requires prospective application of the amendment. Thus, upon transition, an entity does not reallocate to the NCI previous losses that were attributable to NCI but were attributed to the equity of the owners of the parent. The entity allocates subsequent total comprehensive income on the basis of the present ownership interests of the owners of the parent and the NCI.
- When a change in ownership interest in a subsidiary occurs but does not result in the loss of control, the parent must reattribute other comprehensive income between the owners of the parent and the non-controlling interest.

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- Although IFRS 3 permits early application only for periods that begin on or after 30 June 2007, this limitation does not apply to a first-time adopter. Paragraph 7 of IFRS 1 states that a first-time adopter has to use the same accounting policies throughout all periods presented in its first IFRS financial statements.

The Board noted that the FASB is considering whether to amend the scope of SFAS *160 Noncontrolling Interests in Consolidated Financial Statements* so that it would apply only to entities that meet the definition of a business. The Board decided not to propose amendments to the scope of IAS 27. However, the Board will monitor the FASB's progress on that project.

The Board will address the following issues in its projects on financial instruments and joint ventures:

- contingent consideration: designation (categories of financial instruments) and classification (as equity or a liability);
- put options on non-controlling interest (classification as equity or a liability); and
- the interaction between the revised IFRS 3 and IAS 27, and IAS 28 and IAS 31.

The Board deferred the following issues to the post-implementation review of IFRS 3 and IAS 27, to be conducted two years after their effective date:

- The application of the definition of a business in particular situations.
- The application of the definition of non-controlling interest to equity instruments other than shares (for example, share options) and the measurement of those instruments.
- IFRIC recommendations on (a) removing the distinction between 'contractual' and 'non-contractual' customer-related intangible assets in a business combination and (b) including in the standard the indicators that identify the existence of a customer relationship. The Board decided tentatively to retain the depositor relationship example in paragraph B34(a) of IFRS 3, noting that this is a separable intangible asset.
- the treatment of indemnification assets (as part of the business combination transaction or as a separate transaction).

Future Board meetings

The Board will meet in public session on the following dates in 2009. Meetings take place in London, UK, unless otherwise noted.

1 June (extra Board meeting)

5 June (extra Board meeting)

15-19 June

20-24 July (23-24 July with FASB)

14-18 September

19-23 October

26-27 October (IASB and FASB joint meeting, Norwalk USA)

16-20 November

14-18 December

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