IASB Update

From the International Accounting Standards Board

November 2011

Welcome to IASB Update

The IASB met on 15 and 16 November 2011 in a public meeting, with one Board member participating by telephone. Some sessions were held jointly with the FASB Board members participating via videoconference from Norwalk.

The most significant item for the IASB was the decision to defer IFRS 9 *Financial Instruments* and to consider making limited improvements to that standard. The IASB also completed its public voting on the amendments stemming from the offsetting project.

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

- Financial instruments: classification and measurement
- Insurance contracts
- Insurance contracts: education session on residual margins
- Leases
- Macro hedge accounting
- Offsetting—Additional feedback: effective dates
- Work plan

The topics discussed at the IASB meeting were:

- Annual improvements
- IFRS 10 transitional requirements
- Put options written on non-controlling interests

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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 2011 is:

12-16 December

To see all Board meetings for 2011, **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

Limited improvements to IFRS 9 *Financial Instruments*

At this meeting, the IASB decided to consider making limited improvements to IFRS 9 and, in particular, to consider the interaction with the insurance contracts project. This will also enable the IASB to consider the FASB's classification and measurement model.

The IASB also decided to make any changes as soon as possible and to limit the scope of the project to minimise potential disruption to those who have already applied, or who are close to applying, IFRS 9, and to assist in timely completion of the project.

All IASB members voted in favour of this decision.

Effective date of revised disclosure requirements

At the 7 November 2011 Board meeting, the IASB decided that IFRS 9 (2009) and IFRS 9 (2010) should be amended to require application for annual periods beginning on or after 1 January 2015, rather than 1 January 2013.

The IASB also decided not to require the restatement of comparative-period financial statements for the initial application of the classification and measurement requirements of IFRS 9, but instead to require modified disclosures on transition from the classification and measurement requirements of IAS 39 to those of IFRS 9.

The IASB also decided that this disclosure would be required even if an entity chose to restate its comparatives for the effect of applying IFRS 9. Early application of IFRS 9 (2009) and IFRS 9 (2010) would continue to be permitted.

In this meeting, the IASB discussed the effective date for the modified disclosures. The IASB decided that an entity that adopts IFRS 9 for reporting periods:

a. beginning before 1 January 2012 need not restate prior periods and is not required to provide the modified disclosures at the date of initial application;
b. beginning from (and including) 1 January 2012 until (and including) 31 December 2012 shall restate prior periods unless it elects to provide the modified disclosures at the date of initial application instead of restating prior periods; or
c. beginning on 1 January 2013 or thereafter, need not restate prior periods. However, the entity shall provide the modified disclosures at the date of initial application.

All IASB members voted in favour of this decision.

Mandatory effective date of IFRS 9 and disclosures on transition from IAS 39 to IFRS 9

On the basis of the decisions taken on 7 and 15 November 2011, the IASB granted the staff permission to prepare the amendments for balloting.

One IASB member is considering dissenting from the amendments.

Insurance contracts

The IASB and FASB continued their discussions on insurance contracts by considering the accounting for explicit account balances within insurance contracts. In addition, the boards received an oral update on the feedback received at the IASB's Insurance Working Group held on 24 October 2011.

Disaggregation of explicit account balances

The FASB tentatively decided to separate explicit account balances from the insurance contract liability. Explicit account balances are account balances within a contract that meet both of the following criteria:

- The balance is an accumulation of the monetary amount of transactions between the policyholder and an insurer.
- The balance is credited with an explicit return. A return is explicit if it is determined by applying either of the following to the balance:
  - A contractual formula in which the insurer may have the ability to reset the return rate during the life of the contract.
  - An allocation determined directly by the performance of specified assets.

All FASB members supported this decision.

IASB members indicated their preference to measure explicit account balances as part of the insurance contract and to disaggregate them for presentation or disclosure. IASB members indicated that they would like to explore an approach in which some other deposit components of insurance contracts could be disaggregated in the same way. Although some indicative votes were taken, the IASB made no decisions.

The boards plan to consider at a future meeting:

- whether there are additional account balances that should be separated from the insurance contract liability.
- how income and expense items related to the explicit account balances should be recognised in the statement of comprehensive income.
- whether to measure separated account balances:
  - using requirements other than those being developed in the insurance contracts project; or
  - as part of the insurance contract and to disaggregate those account balances for presentation or disclosure.

Next steps

Both boards will continue their joint discussions on insurance contracts in the week commencing 12 December 2011. The FASB plans to hold an education session on participating contracts on 22 November 2011 with the board meeting to follow on 30 November 2011.

Insurance contracts: education session on residual margins

The IASB continued its discussions on insurance contracts by holding an education session to consider issues related to the residual margin. The IASB discussed whether the residual margin established at contract inception should be adjusted (unlocked) to offset changes in estimates and if so which changes in estimates should adjust the residual margin in this way.

Because this was an education session, the IASB was not asked to make any decisions.

Leases

The IASB discussed how a first-time adopter of IFRSs would apply the proposed leases standard in its first IFRS financial statements; consequential amendments to the business combinations guidance in IFRSs and US GAAP; transition issues related to business combinations; consequential amendments to the borrowing costs guidance in IFRSs and US GAAP; and transition requirements for secured borrowings.

IASB—First-time adoption

The IASB tentatively decided that a first-time adopter would be permitted to apply, to all of its lease contracts, the transitional provisions and reliefs that are applicable to the operating leases of an existing IFRS preparer. In addition, the IASB tentatively decided to permit a first-time adopter to initially measure a right-of-use asset at fair value in its opening IFRS statement of financial position and to use that amount as deemed cost.

All IASB members voted in favour of these decisions.

Business combinations and borrowing cost consequential amendments

The boards tentatively decided the following in relation to the measurement of lease assets and lease liabilities acquired in a business combination:

a. If the acquiree is a lessee, an acquirer should recognise a liability to make lease payments and a right-of-use asset. The acquirer should measure:
    i. the liability to make lease payments at the present value of future lease payments in accordance with the proposed leases guidance, as if the associated lease contract is a new lease at the acquisition date; and
    ii. the right-of-use asset equal to the liability to make lease payments, adjusted for any off-market terms in the lease contract.
b. If the acquiree is a lessor applying the receivable and residual approach, an acquirer should recognise a right to receive lease payments and a residual asset. The acquirer should measure:
    i. the right to receive lease payments at the present value of future lease payments in accordance with the proposed leases guidance, as if the associated lease contract is a new lease at the acquisition date; and
    ii. the residual asset as the difference between the fair value of the underlying asset at the acquisition date and the carrying amount of the right to receive lease payments.
c. If the acquiree is a lessor of investment property, an acquirer should apply the guidance in IFRS 3 *Business Combinations* or Topic 805 *Business Combinations* that relates to acquired operating leases.
d. If the acquiree has short-term leases (that is, leases for which, at the date of acquisition, the maximum remaining term of the lease contract is twelve months or less), an acquirer should not recognise separate assets or liabilities related to the lease contract at the acquisition date.

10 IASB members and 6 FASB members agreed.

The boards tentatively decided that, upon transition, a lessee that previously recognised assets or liabilities relating to favourable or unfavourable terms in acquired operating leases should derecognise those assets or liabilities and adjust the carrying amount of the right-of-use asset by the amount of any asset or liability derecognised. All IASB members and 5 FASB members agreed.

The FASB tentatively decided that a lessor applying the receivable and residual approach that previously recognised assets or liabilities relating to favourable or unfavourable terms in acquired operating leases should derecognise those assets or liabilities and make a corresponding adjustment to retained earnings. All FASB members agreed.

The boards tentatively decided that interest expense incurred in a lease should be included in the scope of IAS 23 *Borrowing Costs* and Topic 835 *Interest* for the purposes of determining the interest costs or borrowing costs that could be capitalised. All IASB and FASB members agreed.

Transition-secured borrowings

The boards tentatively decided that, on transition to the new leases guidance, a lessor would continue to account for the securitisation of lease receivables associated with current operating leases as secured borrowings in accordance with existing US GAAP and IFRSs. This tentative decision applies to a lessor regardless of whether it elects a fully retrospective approach to transition. All IASB and FASB members agreed.

Macro hedge accounting

As part of its deliberations on macro hedge accounting the IASB discussed broad alternatives for a basic architecture of a macro hedge accounting model.

IASB members preferred an approach of changing the accounting for the risk position over an alternative of changing the measurement of the hedging instruments.

The IASB discussed various aspects of the valuation approach. For that approach the focus is on the determination and measurement of the risk position. Re-measuring the risk position is a possible way to mitigate some accounting mismatches, and thereby provides a better reflection of the economics.

As a result of the discussion the IASB will continue its deliberations on the basis of using a valuation approach.

No decisions were made.

Offsetting—Additional feedback: effective dates

In July 2011 the IASB and the FASB tentatively agreed on converged disclosures that would amend IFRS 7 *Financial Instruments: Disclosures*. These converged disclosures would provide users of financial statements with information about rights of set-off related to an entity's financial instruments and the effects of such rights on its statement of financial position that would be comparable between IFRSs and US GAAP. In September 2011 the IASB also decided to address inconsistencies in the application of the offsetting criteria in the current IAS 32 *Financial Statements: Presentation* by adding application guidance to IAS 32 to clarify: (1) the meaning of 'currently'; and (2) that some gross settlement systems would be considered to be equivalent to net settlement.

At the November 2011 meeting the IASB discussed additional feedback received about clarifications to the application guidance in IAS 32 and how it may change practice for some entities and affect the amount of time they would need for implementation. This was primarily due to:

- the clarification that a right of set-off must not only be a legally enforceable right in the normal course of business, but that it must also be enforceable in the event of default and the event of insolvency or bankruptcy; and
- the clarification that a right of set-off must be legally enforceable for all parties (ie including the reporting entity).

In September 2011, the IASB had tentatively decided that the converged offsetting disclosures in IFRS 7 and the clarifications to the application guidance in IAS 32 would be retrospectively applied, with an effective date of annual periods beginning on or after 1 January 2013.

In the light of the feedback received, the IASB:

- confirmed that the effective date and transition requirements of the converged offsetting disclosures in IFRS 7 should not be changed. 14 IASB members supported this decision.
- tentatively decided that the clarifications to the application guidance in IAS 32 would be retrospectively applied, with an effective date of annual periods beginning on or after 1 January 2014. 9 IASB members supported this decision.

Work plan

The decisions reached this week have not affected the IASB work plan. The work plan will be updated in the first week of December 2011 to reflect any changes in the status of the due process documents.

IASB sessions

Annual improvements

Aggregation of operating segments and identification of the chief operating decision maker (IFRS 8 *Operating Segments*)

The IASB discussed how concerns raised by the European Securities and Markets Authority (ESMA) regarding the application of the aggregation criteria and the identification of the chief operating decision maker (CODM) in IFRS 8 could be addressed, with reference to how similar concerns had been addressed in US GAAP.

The IASB noted that, in accordance with paragraphs 5 and 7 of IFRS 8, a CODM is actively involved in reviewing information of an operating nature and fulfils two distinct but related functions (ie performance assessment and resource allocation). In addition, paragraph 9 of IFRS 8 states that the CODM generally discusses operating activities, financial results or other plans for the segment with the 'segment manager' or might also fulfil the role of segment manager.

Consequently, the IASB decided that no further clarification of the requirements in IFRS 8 relating to the identification of the CODM is needed. However, the IASB agreed to include an additional disclosure in paragraph 22 of IFRS 8 requiring a brief description of the operating segments that have been aggregated and the economic indicators that have been assessed in order to conclude that the operating segments have 'similar economic characteristics' in accordance with paragraph 12 of IFRS 8.

The IASB will include the proposed amendment to paragraph 22 of IFRS 8 in the next *Improvements to IFRSs* exposure draft. All IASB members voted in favour of this decision.

Classification of interest paid that is capitalised (IAS 7 *Statement of Cash Flows*)

In a past meeting the IASB had tentatively made decisions regarding the classification of interest paid that is classified as part of the cost of an asset and tentatively approved it for inclusion within the Annual Improvements project. In this meeting the IASB confirmed that this issue met the criteria for Annual Improvements.

All IASB members voted in favour of this decision.

Key Management Personnel (IAS 24 *Related Party Disclosures*)

The IASB discussed proposed amendments to IAS 24 to clarify the identification and disclosure requirements for related party transactions that take place when key management personnel (KMP) services are provided by a management entity that is not otherwise a related party of the reporting entity.

The IASB decided not to amend the existing definition of KMP in IAS 24.

However, the IASB tentatively decided to amend IAS 24 to identify entities that provide KMP services as a related party of the reporting entity, and to require the separate disclosure of fees paid to related parties in respect of KMP services. The IASB will include the proposed amendments in the next *Improvements to IFRSs* exposure draft.

All IASB members voted in favour of these decisions.

The IASB also discussed the staff recommendation that compensation provided to the management entity for KPM services would not be compensation as defined in IAS 24—those amounts would not need to be disclosed.

One IASB member voted against this recommendation.

The IASB also tentatively decided to accept the staff's proposal to seek further input on variable payments to related parties and to consider any proposals as part of the 2011-2013 Annual Improvements project.

10 IASB members supported this proposal.

Issue not recommended for inclusion within the Annual Improvements cycle for 2010 2012

Following the IFRS Interpretations Committee's recommendation, the IASB agreed that the timing of recognition of compensation for items of property, plant and equipment that were impaired, lost or given up in paragraph 65 of IAS 16 *Property, Plant and Equipment* (ie 'when the compensation becomes receivable'), is sufficiently understood within IFRSs and no clarification is needed.

Consequently, the IASB agreed with the Interpretations Committee that this issue did not meet the criteria for inclusion in Annual Improvements.

14 Board members voted in favour of this decision.

IFRS 10 transitional requirements

Meaning of the date of initial application in IFRS 10 *Consolidated Financial Statements*

The IFRS Interpretations Committee received three requests to clarify the transitional provisions in IFRS 10. The Interpretations Committee discussed these issues in the September 2011 meeting and recommended that the IASB should consider these issues as a separate exposure draft, rather than as part of Annual Improvements.

In this meeting the IASB discussed the transitional provisions in IFRS 10 and decided to:

a. add a definition of the date of initial application to IFRS 10. This would be 'the beginning of the reporting period in which IFRS 10 is applied for the first time';
b. add a paragraph in IFRS 10 (C3A) to clarify that an entity is not required to make adjustments to the accounting for its involvement with an entity that was disposed of, or whose control was lost, in the comparative period(s); and
c. amend paragraphs C4 and C5 of IFRS 10 to clarify how the investor shall retrospectively adjust comparative periods when the consolidation conclusion changes between IAS 27 *Consolidated and Separate Financial Statements*/SIC 12 *Consolidation—Special Purpose Entities and IFRS 10*.

All IASB members voted in favour of this decision.

Put options written on non-controlling interests

In September 2011 the IASB discussed a recommendation from the IFRS Interpretations Committee for a possible scope exclusion to IAS 32 for put options written on non-controlling interests ('NCI puts') in the consolidated financial statements of the group. The objective of the scope exclusion would be to address a potential conflict between the requirements in IAS 32, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* for measuring financial liabilities and the requirements in

IAS 27 *Separate Financial Statements* and IFRS 10 *Consolidated Financial Statements* for accounting for transactions with owners in their capacity as owners.

At that meeting the IASB voted not to amend the scope of IAS 32 to exclude NCI puts. However the IASB expressed support for considering addressing the potential conflict by clarifying the accounting for subsequent changes in the measurement of the NCI put.

At its November 2011 meeting the Interpretations Committee confirmed that it is willing to consider this issue further. It asked the staff to obtain clear guidance from the IASB on how the IASB would like it to take the issue forward.

At this meeting the IASB discussed what guidance to give to the Interpretations Committee. The IASB voted to ask the Committee to analyse the following two issues:

- whether changes in the measurement of the NCI put should be recognised in profit or loss (P&L) or equity. 9 IASB members expressed a preliminary preference for P&L. The IASB discussed whether those changes should be recognised in other comprehensive income but decided not to pursue that alternative.
- whether the clarification described in the bullet point above should be applied to only NCI puts or to both NCI puts and NCI forwards. 10 IASB members expressed a preference for investigating applying the clarification to both NCI puts and NCI forwards. The IASB discussed whether the clarification should apply to all contracts on an entity's own equity but decided not to pursue that alternative.

The staff will present this information to the Interpretations Committee at a future meeting.

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