BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

January 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 19 – 23 January, when it discussed:

- Global financial crisis
- Annual improvements
- Conceptual framework
- Financial instruments with characteristics of equity
- IFRIC
- IFRS for non-publicly accountable entities
- Income tax
- Leases
- Post-employment benefits
- Technical plan

Global financial crisis

The Board discussed various aspects of its response to the global financial crisis:

- Derecognition
- Financial instruments: disclosures
- Fair value measurement

Derecognition

The Board resumed its discussion of the two approaches to derecognition originally presented at the Board's joint meeting with the US Financial Accounting Standards Board in October 2008. The Board made the following tentative decisions:

for Approach 1:

- To modify the derecognition test to focus on whether the transferor presently has access to the cash flows or other future economic benefits of the financial asset it recognised before the transfer. An accounting outcome of applying the derecognition test is that a transfer of a component of an equity investment may qualify for derecognition.
- To treat as a new financial asset (rather than as a part of the financial asset that the transferor recognised before the transfer) the component of a financial asset or group of financial assets retained in a transfer that qualifies for derecognition.
- To treat as a new asset an investment that a transferor purchases from a transferee securitisation vehicle.

for Approach 2

- For a transfer of a part of a derivative, a hybrid instrument with an embedded derivative that requires bifurcation or an equity instrument, to assess the part (rather than the entire instrument) for derecognition only if it involves specifically identified and/or proportionate cash flows. As a result, if a transferred part of a financial instrument can be either an asset or a liability over its life (eg an interest rate swap) or involves future economic benefits other than cash flows (eg an equity investment), it will not qualify for derecognition.
- To allow transferred financial assets to be evaluated for derecognition as a group, but not allow any of those assets to be instruments that can be either assets or liabilities over their life (eg interest rate swaps) or that involve future economic benefits other than cash flows (eg equity investments).
- In a transfer that qualifies for derecognition, to treat the retained component of a financial asset or group of financial assets as a retained part of the financial asset recognised before the transfer (rather than as a new asset).
- To treat as a new asset an investment that a transferor purchases from a transferee securitisation vehicle.
- To disclose in the notes (rather than in the statement of financial position) the relationship between a transferred financial asset that does not qualify for derecognition and the associated liability, if the transferee's only recourse is to the transferred asset rather than to the transferor.

The Board will continue its discussion in February and expects to publish an exposure draft in March or April 2009.

Fair value measurement

The Board discussed the following:

- Scope assessment
- Fair value disclosures
- Day 1 gains - service contracts
- Transition requirements
- Comment period

Scope assessment

The Board identified three items for which IFRSs use the term 'fair value' in a manner inconsistent with the Board's proposed definition of fair value (a current exit price) and related guidance:

- share-based payment transactions
- reacquired rights in a business combination
- financial liabilities with a demand feature

The Board tentatively decided not to retain the term 'fair value' for these particular measurements. The staff will draft new descriptions that are consistent with the intended measurement objective in each case.

The Board noted that IAS 40 *Investment Property* refers to measuring fair value on the basis of rental income from current leases. The staff will consider whether this is consistent with the proposed fair value measurement guidance.

The Board also discussed the initial measurement of financial instruments that are subsequently measured on a basis other than fair value through profit or loss.

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ISSN 1474-2675

The Board tentatively decided to amend IAS 39 *Financial Instruments: Recognition and Measurement* to specify that an entity would not recognise a gain or loss on initial recognition of these instruments. The deferred gain or loss would be treated in the same way as transaction costs and as other adjustments made in determining the effective interest rate.

Fair value disclosures

The Board tentatively decided to require disclosure of:

- fair value measurements by level of the fair value hierarchy (Level 1, Level 2 or Level 3)
- the methods used and assumptions applied in determining fair value, including any changes to valuation techniques
- a reconciliation from beginning balances to ending balances for Level 3 fair value measurements
- for level 3, the amount of gains or losses recognised in profit or loss that relate to assets and liabilities held at the end of the reporting period
- a sensitivity analysis for Level 3 fair value measurements.

Further details are available on the IASB's website in the observer notes for this meeting. The proposed disclosures about fair value are similar to disclosure requirements adopted by the Board at this meeting for financial instruments (see below).

Day 1 gains—service contracts

In previous discussions, the Board has presumed that the transaction price is generally the best evidence of the fair value of an asset or liability at initial recognition. At this meeting, the Board discussed how this presumption applies to contracts to provide services. The Board tentatively decided that:

- the only true exit market for the service provider is the secondary (wholesale) market with other service providers, not the primary (retail) market with customers.
- the exit price for the service provider reflects the perspective of the service provider, not the perspective of the customer.
- at initial recognition, the exit price for the service provider is likely to differ from the transaction price because the provider will typically price the transaction to recover its direct and indirect origination costs and to provide a reasonable return on the originating activity. In contrast, a transferee would not require payment for the origination activity performed by the original provider.

Transition

The Board tentatively decided that an entity:

- would adjust retained earnings retrospectively on initially applying the proposed IFRS, to recognise any gain or loss previously deferred on initial recognition of a financial instrument classified at fair value through profit or loss.
- would, in all other respects, apply the proposed measurement requirements prospectively from when it initially applies the IFRS.
- need not provide the proposed disclosure requirements for periods before it initially applies the IFRS.

Comment period

The Board tentatively decided that the exposure draft would have a 120-day comment period. The Board expects to publish the exposure draft around the end of March.

Financial instruments: disclosures

The Board discussed the responses to the exposure draft *Improving Disclosures about Financial Instruments* (ED), published in October 2008, and tentatively decided:

- as proposed in the ED, to require a three-level fair value disclosure hierarchy in IFRS 7.
- to use the same hierarchy as in Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* issued by the US Financial Accounting Standards Board (FASB).
- not to require disclosures about the fair value hierarchy for financial instruments that are not measured at fair value. Existing disclosure requirements for those instruments would still apply.
- to emphasise the existing requirement to provide summary data about each type of risk arising from financial instruments based on information provided internally to key management personnel.
- as proposed in the ED, to require disclosure of separate maturity analyses for derivative and non-derivative financial liabilities.
- to retain the existing minimum contractual liquidity risk disclosures for non-derivative financial liabilities.
- not to require the existing minimum contractual liquidity risk disclosures for some types of derivative financial liabilities.
- to require entities to apply the final amendments for annual periods beginning on or after 1 January 2009, with earlier application permitted and comparative disclosures not required on transition.

The Board directed the staff to draft the final amendments for written ballot.

The Board also discussed responses to the exposure draft *Investments in Debt Instruments*, published in December 2008, and decided not to proceed with the proposed amendments at this time. The Board will consider the issues addressed in the exposure draft and other issues in its broader project on improving the accounting for financial instruments.

Annual improvements

The Board approved the project plan and a timetable for issuing improvements to IFRSs in April 2009, based on the exposure draft published in August 2008.

The Board reaffirmed seven of the proposed amendments on:

- Scope of IFRS 2 *Share-based payment* and revised IFRS 3 *Business Combinations* (IFRS 2)
- Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations (IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*)
- Classification of expenditures on unrecognised assets (IAS 7 *Statement of Cash Flows*)
- Determining whether an entity is acting as a principal or as an agent (IAS 18 *Revenue*)
- Unit of account for goodwill impairment test (IAS 36 *Impairment of Assets*)
- Additional consequential amendments arising from revised IFRS 3 (IAS 38 *Intangible Assets*)

- Measuring the fair value of an intangible asset acquired in a business combination (IAS 38)

The staff will present an analysis of the comment letters for three proposals in February:

- Disclosure of information about segment assets (IFRS 8 *Operating Segments*)
- Scope exemption for business combination contracts (IAS 39)
- Cash flow hedge accounting (IAS 39)

The Board will defer redeliberations of the remaining two proposals:

- Application of the fair value option (IAS 39)
- Bifurcation of an embedded foreign currency derivative (IAS 39)

Conceptual framework

The Board discussed phases A, C and D of the project on the conceptual framework.

Phase A - qualitative characteristics and constraints of financial reporting

The Board reviewed responses to the exposure draft (ED) *An improved Conceptual Framework for Financial Reporting: Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information* and tentatively reconfirmed the following proposals made in the ED.

- to use the term 'faithful representation' to refer to the characteristic labelled as 'reliability' in the existing *Framework*.
- to classify relevance and faithful representation as fundamental characteristics. In response to comments received, the Board will clarify that the components of faithful representation (neutrality, completeness and freedom from error) are not absolutes.
- to classify verifiability, comparability, timeliness and understandability as enhancing characteristics.
- to describe materiality and cost as constraints on financial reporting.

Phase C – measurement

The Board discussed which measurement bases should be included in the framework and how they might be grouped to facilitate discussion and decisions about measurement issues. The Board also discussed possible simplifications to current and possible bases that might improve the use of a mixed-basis measurement system. No decisions were made.

Phase D – reporting entity

The Board discussed some of the issues arising from responses to the discussion paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*. The Board tentatively decided:

- to revise the description of a reporting entity to state that a reporting entity is a circumscribed area of economic activity whose financial information has the potential to be useful to present and potential equity investors, lenders and other capital providers for decisions in their capacity as capital providers.
- to update the list of capital providers in the description of a reporting entity if any changes are made to the list of the primary users of financial information in Chapter 1 *The Objective of Financial Reporting.*
- to clarify that an entity can be a reporting entity even if it is currently inactive.

Implications of the description of a reporting entity

The Board also tentatively affirmed the following decisions:

- A reporting entity need not be a legal entity.
- A legal entity could, but would not necessarily, meet the description of a reporting entity.
- A branch or segment of a legal entity could, but would not necessarily, meet the description of a reporting entity.

Group reporting entity

The Board tentatively decided that:

- if the reporting entity controls other entities, it should present consolidated financial statements using the controlling entity model.
- when the controlling entity is not a reporting entity, it may be useful to present combined financial statements of entities under common control.
- an assessment of risks and rewards might be useful for implementing the controlling entity model in some circumstances, but should not replace control as the basis for identifying the entities to be consolidated.
- parent-only financial statements should not be mandatory but may provide useful information if they are presented together with consolidated financial statements.

Next steps

The Board and the FASB will continue their discussions in March.

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 considered an analysis of the comment letters received and decided to begin future deliberations using the principles underlying the perpetual and basic ownership approaches.

At this meeting, the Board discussed the classification of puttable and mandatorily redeemable instruments. The Board directed the staff to analyse further an approach that would identify different types of such instruments and consider whether those types should be classified differently. For example, the Board discussed the following types of instruments:

- instruments that are puttable or mandatorily redeemable on a specified date or dates
- instruments that are puttable or mandatorily redeemable upon the occurrence of an event that is certain to occur

The Board also discussed the conceptual definitions of a liability and equity. The Board directed the staff to develop an approach that separates the objectives of:

- determining what things qualify for potential recognition (a conceptual definition) and

- determining how those things should be classified (a standards-level principle or principles).

IFRIC

IFRIC 18 – approval of interpretation

The Board approved IFRIC 18 *Transfers of Assets from Customers* and decided that an entity:

- should apply IFRIC 18 prospectively to assets received from customers on or after 1 July 2009;
- may apply IFRIC 18 earlier if it obtained the valuations and other information needed to apply the Interpretation to past transfers at the time those transfers occurred;
- should disclose the date from which it applied the Interpretation.

IFRIC 9 – proposed consequential amendment

The Board was advised that the changed definition of a business combination within revised IFRS 3 caused embedded derivatives acquired during the formation of a joint venture to be within the scope of IFRIC *9 Reassessment of Embedded Derivatives*. The Board noted that common control transactions may also be within the scope of IFRIC 9 depending on which level of the group reporting entity is assessing the combination.

The Board decided to propose an amendment to paragraph 5 of IFRIC 9 to exclude from its scope embedded derivatives in contracts acquired in combinations of entities or businesses under common control and in the formation of joint ventures.

The Board decided to publish an exposure draft of this proposal in January with a 30-day comment period. The Board expects to finalise the amendment at its meeting in March.

IFRIC 16 – proposed amendment

IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* does not permit hedge accounting if the hedging instrument is held by the foreign operation that is being hedged. At this meeting, the Board decided to propose an amendment to paragraph 14 of IFRIC 16 to remove this restriction.

The Board decided to publish an exposure draft of this proposal in January with a 30-day comment period. The Board asked the staff to present an analysis of the comment letters at the IFRIC meeting in March to obtain input from the IFRIC. The Board expects to finalise the amendment at its meeting in March.

IFRIC 14 – voluntary prepayments

The Board considered a proposal to amend IFRIC 14 *IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* to eliminate an unintended consequence that arises from some voluntary prepayments to a defined benefit plan that is subject to a minimum funding requirement.

The Board tentatively decided to amend IFRIC 14 so that an entity recognises an asset for a prepayment that will reduce future contributions by the entity. (This is View C as set out in the observer notes). The staff will draft for written ballot an exposure draft proposing these changes.

IFRS for non-publicly accountable entities

The Board continued its discussion of issues relating to the exposure draft (ED) of a proposed *IFRS for SMEs* and reached the following tentative decisions.

Title of the standard. The name of the final standard should be International Financial Reporting Standard for Non-publicly Accountable Entities, or IFRS for NPAEs.

Complex accounting policy options. In May 2008 the Board tentatively decided that, in general, all accounting policy options in full IFRSs should be available to NPAEs. As in the ED, the body of the standard should include the simpler option. The more complex options would be in a separate appendix rather than cross-referenced to full IFRSs. At this meeting, the Board made the following tentative decisions:

- *Investment property*. Measurement should be circumstance-driven rather than allowing NPAEs an accounting policy choice between the cost and fair value models. If an NPAE can the measure fair value of an item of investment property reliably without undue cost or effort, it must use the fair value model. Otherwise, it must use the cost model.
- *Property, plant and equipment.* The revaluation model should not be an option.
- *Intangible assets.* The revaluation model should not be an option.
- *Borrowing costs.* All borrowing costs should be recognised as an expense. The capitalisation model should not be an option.
- *Presenting operating cash flows.* NPAEs could use either the indirect method or the direct method to present operating cash flows in the cash flow statement.
- *Development costs.* All research and development costs should be recognised as an expense. Capitalisation of development costs should not be an option.
- *Financial instruments.* An NPAE could apply either Section 11 of the IFRS for NPAEs or all requirements of full IFRSs – the three financial instrument standards (IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement*, IFRS 7 *Financial Instruments: Disclosures*), and related interpretations. The option to use full IFRSs will be available by cross-reference. This will be the only cross-reference to full IFRSs.
- *Associates.* The options proposed in the ED (cost method, equity method, and fair value through profit or loss) should all be allowed.
- *Jointly controlled entities***.** The options in the ED should all be allowed with the exception of proportionate consolidation. Therefore NPAEs could choose the cost method, equity method, or fair value through profit or loss.

Consolidation. Consolidated financial statements should be required for all NPAE groups, with limited exceptions, as proposed in the ED.

Goodwill and other indefinite-life intangible assets. For cost-benefit reasons, rather than conceptual reasons, goodwill and other indefinite-life intangible assets should be considered to have finite lives. Therefore, such assets should be amortised over their estimated useful lives, with a maximum amortisation period of 10 years. The assets must also be assessed for impairment using the 'indicator approach' proposed in the ED.

Financial instruments. The staff presented a full redraft of Section *11 Financial Assets and Financial Liabilities* reflecting tentative decisions made by the Board in June 2008 and December 2008.

In June 2008 the Board decided to restructure Section 11 into two parts. Section 11A deals with simple payables and receivables and other basic financial instruments. Section 11B deals with more complex instruments and transactions. In December, the Board considered the first draft of Section 11A. At this meeting the staff presented an updated version of Section 11A along with a first draft of Section 11B.

The Board was supportive of the rewrite of Section 11A. However, the Board made a few amendments, including:

- A commitment to make a loan should be addressed in Section 11B, not 11A.
- Some of the draft criteria to establish whether a debt instrument is in Section 11A need to be clarified.
- Regarding initial measurement, Section 11A would require that if payment is deferred the instrument must be measured at the present value of payments discounted at a market rate of interest. The standard should be clear that the market rate of interest is a rate applicable to the risks and terms of the instrument in question.
- If short-term financial instruments have no stated interest rate, their initial measurement should be consistent with the requirements in full IFRSs.
- The effective interest method should use the weighted average amount of the receivable or payable outstanding during the period, not the carrying amount at the beginning of the period.
- The proposed guidance on factoring of receivables should be replaced by examples of applying the general derecognition principles to factoring transactions.

The Board was supportive of the rewrite of Section 11B. A few minor drafting issues were highlighted.

Special purpose entities. The principles in SIC-12 should be incorporated into Section 9 *Consolidated and Separate Financial Statements*.

Measurement of post-acquisition income. An investor choosing to apply the cost model to its investments in associates or joint ventures would not separate pre- and post-acquisition retained earnings of the investee. Instead, all dividends received will be recognised in profit or loss.

Outstanding issue. In February, the Board will discuss the only substantial issue outstanding: simplification of defined benefit pension accounting.

Income taxes

The Board considered whether the exposure draft on income tax should propose that entities should discount current tax refundable or payable. The Board decided tentatively that the exposure draft should be silent on the matter.

Leases

At this meeting, and in a joint videoconference meeting with the FASB, the Board discussed the content and timing of the proposed discussion paper on lease accounting. The boards decided to include in the discussion paper a high level discussion of lessor accounting issues. The boards plan to publish the discussion paper in March 2009.

The IASB also tentatively decided not to exclude from the scope of the project contracts that are 'in-substance purchases'.

Post-employment benefits

The Board tentatively decided to work from the proposals in the discussion paper (DP) *Preliminary Views on Amendments to IAS 19 Employee Benefits* and the responses to the DP towards two separate exposure drafts, as follows:

- Part 1: Recognition and presentation of changes in the defined benefit obligation and in plan assets, disclosures, and other issues raised in the comment letters that can be addressed expeditiously.
- Part 2: Contribution-based promises, potentially as part of a comprehensive review of pension accounting.

On part 1 the Board tentatively decided that entities should:

- disaggregate changes in the defined benefit obligation and in plan assets into employment, financing and remeasurement components, and recognise the components in the income statement. The Board will consider at a future meeting how to define those components.
- disclose the employment and financing components either in the income statement or in the notes, and present the remeasurement component in the income statement. The Board plans to explore ways to present the remeasurement component in a way that distinguishes it from other items of profit or loss.

The Board will continue its discussion in February.

Technical plan

The Board made its quarterly review of its Technical Plan. The Plan sets out the expected timetable over the next 36 months for projects on the IASB's active agenda and research agenda. The revised timetable is available at: http://www.iasb.org/Current+Projects/IASB+Projects/IASB+Work+Plan.htm. Project summaries are available on the IASB Website at: http://www.iasb.org/Current+Projects.

Future Board meetings

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

2009

16-20 February

16-20 March

23-24 March (IASB and FASB joint meeting)

20-24 April

18-22 May

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)

16-20 November

14-18 December