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IN THE HEADLINES
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December 2010 IASB meetings

Summary

The December meetings of the IASB[1] took place on 1, 3, 8 and 13 – 17 December. The summary below combines the outcomes of the individual sessions from the December meetings. In a number of sessions the IASB held joint discussions with the FASB[2] as indicated throughout. The following projects were discussed:

- consolidation
- fair value measurement
- financial instruments
- insurance contracts
- post-employment benefits
- revenue recognition.

The IASB approved amendments to:

- the first-time adoption standard to replace certain fixed dates and add a deemed cost exemption for first-time adopters that have been subject to severe hyperinflation (refer Briefing Sheet – *Issue 228*); and
- the income taxes standard to add an exception in respect of the measurement of deferred tax on investment properties measured at fair value under the investment property standard (refer Briefing Sheet – *Issue 229*).

In addition, the IASB received an update on the IASB Advisory Council meeting held in London in November 2010.

- Judgements in the assessment of control likely to change under the new consolidation standard; could affect consolidation decisions.
- Discussions on the fair value measurement project finalised; final standard being drafted.
- Key features for a revised financial asset impairment model confirmed; to be published for comment in January 2011.
- Defined benefit plan administration costs to be expensed as incurred and non-routine settlements to be presented in profit or loss.

Consolidation project

The IASB discussed the feedback received on the staff draft of the forthcoming standard on consolidated financial statements and the staff's proposals on how to address the concerns raised. The proposals include clarifications on the control principle, potential voting rights and principal vs agent analysis. The IASB decided to proceed with finalising the forthcoming standard, subject to the clarifications recommended by the staff with one exception. The IASB did not agree that reference should be made to the *capital market environment* and *cultures* in an explanation about the assessment of control to be included in the Basis for Conclusions.

The IASB decided to defer its decision on the effective date of the three forthcoming standards on consolidated financial statements, joint arrangements and disclosure of interests in other entities. However, the IASB agreed tentatively that it should not be earlier than 1 January 2013. The IASB is expected to discuss the effective date of these standards at a future meeting, taking into consideration the feedback received on the request for views on effective dates and transition methods.

Fair value measurement project

In respect of a liability issued with an inseparable third-party credit enhancement, the IASB and the FASB (the Boards) decided tentatively that:

- the requirement to measure the fair value of such liability applies only to guarantees purchased by the issuer of the liability and does not apply to liabilities guaranteed by other entities within the consolidated group; and
- the unit of account is the obligation without the credit enhancement when measuring the fair value of such liability, i.e. the entity should use its own credit standing, not that of the third-party guarantor.

These tentative decisions generally are consistent with the current requirements under US GAAP and the proposals in the IASB exposure draft. The IASB also decided tentatively to require an entity to disclose the existence of a third-party credit enhancement of a liability that it has issued, which is currently required by US GAAP.

The Boards decided tentatively that the fair value measurement disclosure requirements also apply to fair value-based measurements, e.g. fair value less costs to sell.

The IASB decided tentatively to exclude plan assets measured at fair value under IAS 19 *Employee Benefits* from the scope of the fair value measurement disclosure requirements; the disclosure requirements for plan assets will remain in IAS 19.

The IASB decided tentatively to require the following disclosures, in addition to the disclosure requirements under IAS 36 *Impairment of Assets,* if an impairment loss is recognised and the recoverable amount is determined on the basis of fair value less costs to sell under IAS 36:

- amount of the fair value measurement;
- level of the fair value measurement within the fair value hierarchy;
- if applicable, changes to valuation techniques and reasons for those changes; and
- quantitative information about significant inputs used in measuring fair value.

The IASB is expected to discuss the necessity of the disclosure about whether the highest and best use of the asset measured at fair value differs from the current use of the asset at a future meeting. The IASB also is expected to discuss the effective date of the forthcoming standard on fair value measurement at a future meeting, taking into consideration the feedback received on the request for views on effective dates and transition methods.

Financial instruments project

Amortised cost and impairment

Method to recognise expected credit losses

The Boards discussed the three alternative methods to recognise expected credit losses that were presented previously and supported tentatively a variation of one of the three methods. Under that variation of the method, an entity would recognise the higher of the following for the "good" book:

- a loss estimate based on the amount of credit losses expected to occur within a period that can be estimated reliably as being no less than 12 months; and
- a time-proportionate allowance balance calculated as the entity's allowance for losses.

An entity also would recognise impairment in the "bad" book to cover the full lifetime expected losses. The Boards are expected to publish a supplemental document (upcoming document) seeking input from constituents on this model in January 2011.

Scope of the upcoming document

The IASB discussed how to continue to develop the impairment model and confirmed its direction as follows:

- the upcoming document will focus on open portfolios of financial assets but will include a question about the applicability of the model to other instruments, including closed portfolios and single instruments;
- short-term trade receivables would be excluded;
- for the good book the time-proportionate amount of the revised lifetime expected loss estimate would be allocated to the relevant period using either a straight-line approach or an annuity approach, with a question as to whether a particular approach should be required. When discounting expected losses, entities may use a discount rate that lies between the risk-free rate and the effective interest rate as determined under IAS 39 *Financial Instruments: Recognition and Measurement*; and
- loans would be included in the good book or the bad book according to the entity's internal credit risk management criteria supplemented by an objective that if the uncertainty about collectability has taken precedence over the profitability from the interest margin, then the asset should be included in the bad book.

The IASB decided tentatively to include a question as to whether loan commitments that are not measured at fair value should be included in the scope. The IASB also decided tentatively to explain the effect of the proposal on financial guarantee contracts and provide the background, which consists of the related redeliberations as part of the insurance contracts project.

Presentation and disclosure requirements for open portfolios

The IASB decided tentatively on the following presentation and disclosure requirements based on the model developed for open portfolios:

- In the statement of comprehensive income, an entity would present interest revenue separately from impairment expense based on the effective interest rate as determined under IAS 39.
- Examples will be provided in the upcoming document for additional guidance on the level of aggregation that can be considered appropriate for disclosures of credit risk within

the principles set out in IFRS 7 *Financial Instruments: Disclosures*.

- An entity may incorporate the proposed disclosures by cross-reference to other statements that are publicly available to users on the same terms as the financial statements and at the same time.
- For the allowance account for credit losses, an entity would disclose:
  - separate reconciliations for the allowance accounts for the good book and the bad book;
  - if losses expected to occur within the upcoming period are higher than the target allowance for the good book, the additional provision amount; and
  - a reconciliation of the nominal amounts of loans in the bad book.
- For the good book, an entity would disclose the following information in tabular format for the past five years:
  - lifetime expected losses;
  - balance of the outstanding nominal amount;
  - target allowance balance; and
  - additional provisions to reach the floor, if applicable.
- If a particular portfolio or geographical area has significant effects on the gains and losses, then an entity would disclose quantitative and qualitative analyses of the gains and losses.
- For credit risk management and the distinction between the good book and bad book, an entity would disclose:
  - a qualitative analysis of how loans are managed in both books;
  - inclusion of the criteria set for transferring loans from the good book to the bad book;
  - if an entity uses an internal credit rating system, then information about that system; and
  - how the internal credit rating grades are assigned to both books.
- An entity would disclose the nominal amount and information about expected losses, which are both lifetime expected losses and credit losses expected to occur in the upcoming period, across a sufficient number of credit risk rating grades to allow meaningful differentiation of expected losses across the different credit grades. At a minimum, an entity would differentiate between a good book and a bad book.
- For both lifetime expected losses and credit losses expected to occur in the upcoming period, an entity would disclose:
  - the basis of inputs and the estimation technique used to determine the credit losses;
  - an explanation of any changes in estimates and the reason for the change; and
  - an explanation of any changes in estimation technique and the reason for the change.
- In disclosing the comparison of expected losses with actual outcomes, if an entity performs back testing, then it would provide quantitative analysis that compares the actual outcomes with the previous expected loss estimate. In some instances an entity also would provide qualitative explanation. If an entity does not perform back testing, then it would disclose a qualitative analysis of expected losses and the actual outcomes.
- An entity would transfer from the good book to the bad book a provision for credit losses reflecting the part attributable to the loan transferred to the bad book.
- An entity would not need to provide disclosures regarding the sensitivity of assumptions.

The IASB is expected to have further discussions with the FASB on whether the disclosures discussed will be included within the main document or a separate document.

Asset and liability offsetting

The Boards decided tentatively to require an entity to offset a recognised financial asset and financial liability if the offset criteria are met, irrespective of whether the right of offset arises from an arrangement between two parties or more than two parties. The Boards also decided tentatively that the proposed requirements would be applied retrospectively.

The Boards decided to require an entity to disclose information including:

(a) the gross carrying values before offset and other mitigating factors;

(b) the amounts offset under the offset criteria and the net carrying amount reported in the statement of financial position;

(c) the portion of the net carrying amount that is covered by each type of conditional and legally enforceable right of set-off;

(d) the following types of collateral:

- the amount of cash obtained or pledged as collateral in respect of those assets and liabilities;
- the carrying amount of other financial instruments pledged as collateral; and
- the fair value of other financial instruments received as collateral; and

(e) the net exposure after taking into account the effect of the items in (b) – (d) above.

The information would be provided by category of financial instrument, in a single note and in a tabular format unless another format is more appropriate, and separately for financial assets and financial liabilities. Additionally, the Boards decided to require an entity to provide a description of the nature of offset agreements for the amounts included in item (c) above.

An exposure draft is expected to be prepared for vote by balloting.

Post-employment benefits project

The IASB discussed the proposals in the exposure draft on defined benefit plans and the issues raised in the comments received in respect of settlements and curtailments, multi-employer plans and other issues.

Settlements and curtailments

The IASB decided tentatively:

- to limit the definition of curtailment to a significant reduction in the number of employees covered by a plan and exclude from the definition a reduction in benefits for future service. However, in some cases, past service cost arises if a change in benefits for future service results in a change in benefits attributed to past service;
- to exclude from the definition of settlements plan amendments that result in past service cost and curtailments;
- to exclude from the definition of non-routine settlements benefit payments in accordance with the terms of the plan;
- to require gains and losses on routine settlements to be presented in the remeasurements component; and
- to confirm the proposals in the exposure draft for the disclosure of past service cost, curtailments and non-routine settlements but not to require distinguishing between these items if they occur together and are presented in the same component.

Multi-employer plans

The IASB decided tentatively:

- to retain the requirement in IAS 19 that an entity accounts for its participation in a defined benefit multi-employer plan in the same way as for any other defined benefit plan unless insufficient information is available, in which case an entity accounts for the plan as if it were a defined contribution plan;
- to confirm the proposed disclosure for multi-employer plans, but to limit the disclosure of the withdrawal liability to qualitative information and to specify that an entity would recognise and measure any withdrawal liability in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- to confirm the proposed disclosure for multi-employer plans treated as if they were defined contribution plans, but to reduce the period for the required disclosure of future contributions from 5 years to 1 year and to require an indication of an entity's level of participation in a plan, e.g. the proportion of total members or the proportion of total contributions.

Other issues

The IASB decided tentatively:

- to require plan administration costs to be expensed as incurred, for practical reasons, subject to feedback on this decision from the employee benefits working group;
- to confirm the proposed accounting for taxes payable by the plan;
- to confirm the proposed clarification that mortality assumptions include current estimates of expected changes in mortality;
- to confirm the proposal to update the disclosures for defined benefit state plans to be consistent with those for defined benefit multi-employer plans if the information for the state plans is available;
- to confirm the proposal to update the disclosures for group plans to be consistent with those for defined benefit plans, and to allow the information to be included by cross-reference to disclosures in the parent's financial statements under certain conditions;
- to withdraw the proposal to incorporate IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* into IAS 19;
- to withdraw the proposal to require entities to consider expected future salary increases in determining whether a benefit formula allocates a materially higher level of benefit in later years; and
- not to make any additional amendments regarding interim reporting.

Other projects with no technical decisions made

The discussion of the following projects focussed more on timing and project planning; no technical decisions were made.

- **Insurance contracts project.** The Boards considered background material for further discussion on the feedback received on the IASB exposure draft and the FASB discussion paper on insurance contracts, including a proposed project timetable, a summary of outreach activities and an overview of the main issues raised.
- **Revenue recognition project.** The Boards discussed the feedback received on their exposure draft on revenue recognition from contracts from customers and a summary of outreach activities. The Boards are expected to redeliberate the issues raised including the two fundamental issues, which are identifying separate performance obligations and determining the timing of transfer of goods or services to a customer.

Abbreviations

1 IASB: International Accounting Standards Board

2 FASB: US Financial Accounting Standards Board

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