KPMG
cutting through complexity™

IN THE HEADLINES
February 2011, Issue 2011/03

January 2011 IASB meetings

- Inconsistency expected in treatment of potential voting rights when assessing significant influence and control.
- Boards to explore approaches to apply the leases right-of-use model for both lessees and lessors.
- Presentation of defined benefit remeasurements in profit or loss to be permitted in limited circumstances.
- Requirements regarding segmentation of contracts for revenue recognition to be simplified.

Summary

The January meetings of the IASB[1] took place on 17 – 21 January 2011. The summary below combines the outcomes of the individual sessions from the January meetings. In a number of sessions the IASB held joint discussions with the FASB[2] as indicated throughout. The following projects were discussed:

- annual improvements
- consolidation and joint arrangements
- insurance contracts
- leases
- post-employment benefits
- revenue recognition.

The IASB approved a 60-day comment period for the supplement to the exposure draft on amortised cost and impairment of financial instruments that was published in November 2009.

The IASB also received an update on the Interpretations Committee[3] meeting held in January 2011.

Annual improvements project

The IASB agreed tentatively to replace the objective of financial statements contained in IAS 1 *Presentation of Financial Statements* with the objective of financial reporting, and to replace the definition of understandability to be consistent with the definition in the Conceptual Framework that was published in September 2010.

These proposed amendments are expected to be included in the annual improvements cycle for 2010-2012.

The IASB also discussed the summary of the comments received on the proposed amendments to the Due Process Handbook of the IASB that was published in August 2010. The IASB generally agreed with the suggestions by the Interpretations Committee to refine wording of the proposed qualifying criteria for annual improvements.

The views of the IASB and the Interpretations Committee are expected to be included in the recommendations to the IFRS Foundation's Trustees.

Consolidation and joint arrangements project

The IASB decided tentatively not to change the requirements in IAS 28 *Investments in Associates* regarding potential voting rights when assessing significant influence to be consistent with those developed in the consolidation project. The basis for conclusions to the revised IAS 28 is expected to explain why those requirements in IAS 28 have not been changed, at least for the time being. This inconsistency may be addressed as part of a comprehensive review of the definition and assessment of significant influence after June 2011.

The IASB held an education session on the forthcoming standard on joint arrangements, which is expected to be published during the first quarter of 2011.

Insurance contracts project

The IASB and FASB (the Boards) discussed the feedback received in the comment letters on the IASB's exposure draft and the FASB's discussion paper on insurance contracts. The main topics discussed were constituents' reaction to the volatility arising from the proposed measurement model, the proposed discount rate, risk adjustments and margins, unbundling, the modified approach for short-duration contracts, the new presentation and disclosure requirements, and transition.

In an education session, guest speakers presented alternative approaches to determine discount rates for non-participating insurance contracts. The alternatives to the bottom-up approach proposed in the exposure draft and discussion paper discussed included:

- an economic default adjusted discount rate;
- a reference asset portfolio-based discount rate; and
- an asset-linked discount rate.

These top-down approaches start with the return on a specified portfolio of assets and deduct components that do not reflect the characteristics of the insurance liability being measured, compared with the bottom-up approach in the exposure draft and discussion paper, which starts with a risk-free interest rate and adds an adjustment for illiquidity. No decisions were made.

Leases project

The Boards considered a summary of the comments received on the exposure draft on leases that was published in August 2010, and feedback from outreach activities undertaken after the publication of the exposure draft.

The Boards discussed the definition of a lease and how to distinguish between a lease contract and a service contract. The Boards also discussed whether all lease contracts should have the same subsequent measurement approach under the right-of-use model. No decisions were made.

The Boards also discussed the next steps for redeliberating the lessor accounting model proposed in the exposure draft. The Boards decided tentatively to continue to address lessee and lessor accounting issues together. The Boards may decide later in the current leases project whether changes to the present lessor accounting model are needed, and if so, whether these changes should be made as part of the current leases project or as part of a separate project.

The Boards noted that the following issues were raised by respondents:

- Under the proposals the right-of-use model would be applied consistently by all lessees; however, application by lessors would depend on whether the lessor retains exposure to significant risks and benefits associated with the underlying assets.
- Some lessees and lessors enter into lease contracts to finance the use of an underlying asset, and others enter into lease contracts for other reasons including the operational flexibility provided by the contract.

The Boards are expected to explore whether there should be two approaches to apply the right-of-use model for both lessees and lessors, which would result in two different patterns of profit or loss recognition, and how to differentiate between the two approaches.

Post-employment benefits project

The IASB discussed the issues raised in the comments received in respect of the presentation of the remeasurement component of defined benefit cost, and settlements and curtailments.

Presentation of the remeasurement component

The IASB discussed its previous tentative decision to permit an entity to elect to present the remeasurement component either in profit or loss or in other comprehensive income. The IASB decided tentatively that, although remeasurements should be presented in other comprehensive income, under certain circumstances it would be appropriate to allow an entity to elect to present remeasurements in profit or loss, primarily to address accounting mismatches. The decision was supported by nine members on the condition that any such election would need to be irrevocable and that amounts recognised previously in other comprehensive income would not be reclassified to profit or loss. The IASB unanimously supported a requirement for an entity to disclose why the remeasurements are presented in profit or loss. The IASB is expected to discuss whether any other restrictions would be necessary.

Settlements and curtailments

The IASB decided tentatively that:

- if a curtailment or plan amendment arises as part of a restructuring plan or is linked to termination benefits, then the gain or loss should be recognised at the earlier of when the related restructuring costs or termination benefits are recognised, or when the curtailment or plan amendment occurs. Otherwise, the gain or loss should be recognised when the curtailment or plan amendment occurs; and
- if a termination benefit arises as part of a restructuring plan, then the termination benefit should be recognised at the earlier of when the related restructuring costs are recognised, or when the entity no longer can withdraw an offer of the termination benefits. Otherwise, termination benefits should be recognised when the entity no longer can withdraw an offer of the benefits.

The IASB also decided tentatively to confirm the proposal in the exposure draft that the gain or loss on a settlement should be recognised when the settlement occurs.

Revenue recognition project

In the redeliberations on the exposure draft on revenue from contracts with customers, the Boards discussed segmenting a contract, identifying separate performance obligations, and determining the transfer of goods and services. The Boards supported an approach to develop the project along the lines described below.

Segmenting a contract

The Boards decided tentatively to eliminate the proposed requirement in the exposure draft to account for a single contract as two or more contracts if some goods or services in the contract are priced independently from other goods or services in the same contract. Consequently, an entity would separate a contract only if the entity identifies separate performance obligations in the contract. The Boards are expected to discuss further the implications of this decision on allocating the transaction price.

Identifying separate performance obligations

The Boards decided tentatively that the forthcoming standard should clarify that the objective of identifying separate performance obligations is to depict the transfer of goods or services and the profit margin that is attributable to those goods or services.

The Boards decided tentatively to retain the principle of *distinct goods or services* as the basis for identifying separate performance obligations. The Boards are expected to discuss further the attributes of a distinct good or service, including distinct function, separable risks, and different pattern of transfer to the customer, and to consider how an entity would apply them in various scenarios.

The Boards also decided tentatively not to include additional requirements on accounting for perfunctory, incidental or other similar obligations in the forthcoming standard.

Determining the transfer of goods and services

The Boards affirmed that an entity should recognise revenue to depict the transfer of goods and services to a customer.

Goods

The Boards decided tentatively that an entity should recognise revenue for a good when the customer obtains control of the good. The Boards also decided tentatively that the forthcoming standard should:

- carry forward most of the proposed guidance on control from the exposure draft;
- describe rather than define control;
- add 'risks and rewards of ownership' as an indicator of control; and
- eliminate 'the design or function of the good or service is customer-specific' as an indicator of control.

Services

The Boards decided tentatively that an entity should recognise revenue for its performance of contractually-agreed tasks if:

- the customer controls the work-in-process;
- another entity would not need to reperform the task if it were required to fulfill the remaining obligation to the customer; or
- the entity has a right to payment for the performed task and its performance to date could not be put to an alternative use by the entity, i.e. the performance to date has not created an asset that could be transferred to another customer.

The Boards also decided tentatively that an entity should recognise revenue for a service only if the entity could measure reasonably its progress toward successful completion of the service. The Boards are expected to discuss further methods to measure progress toward completion of a service, e.g. an output method, an input method, or a method based on the passage of time.

Goods and services

The Boards decided tentatively that if an entity transfers both goods and services, then the entity should:

- account for them as separate performance obligations if the goods and services are distinct; and
- account for the bundle of non-distinct goods and services as a service if the goods and services are not distinct.

Whether the goods and services are distinct should be determined in accordance with the guidance on identifying separate performance obligations.

Abbreviations

1 IASB: International Accounting Standards Board

2 FASB: US Financial Accounting Standards Board

3 Interpretations Committee: IFRS Interpretations Committee

KPMG International Standards Group is part of KPMG IFRG Limited.

Publication name: *In the Headlines*

Publication number: Issue 2011/03

Publication date: February 2011

kpmg.com/ifrs

In the Headlines **is KPMG's update on International Financial Reporting Standards (IFRSs) and financial reporting related regulatory developments.**

If you would like further information on any of the matters discussed in this issue of *In the Headlines*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.