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IN THE HEADLINES
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February 2011 IASB meetings

Highlights

- The IASB to work towards a June 2011 target for the issuance of a new standard on insurance contracts.
- The Boards to perform targeted outreach on a new definition of a lease and new types of leases: finance leases and other-than-finance leases.
- Defined benefit remeasurements to be presented in other comprehensive income in accordance with the original proposal.
- Criteria for separate performance obligations and revenue recognition for services to be clarified.

The February meetings of the IASB[1] took place on 1, 2 and 15 – 18 February 2011. The summary below combines the outcomes of the individual sessions from the February meetings. In a number of sessions the IASB held joint discussions with the FASB[2] as indicated throughout. The following projects were discussed:

- consolidation and joint arrangements
- financial instruments
- insurance contracts
- leases
- post-employment benefits
- revenue recognition.

The IASB and the FASB (the Boards) also discussed measurement uncertainty as a cross-cutting issue arising from the insurance contracts, leases and revenue recognition projects.

Consolidation and joint arrangements project

The IASB discussed the effective date and transition requirements of the forthcoming standards: IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests with Other Entities*, IAS 27 *Separate Financial Statements (as revised in 2011)* and IAS 28 *Investments in Associates and Joint Ventures (as revised in 2011)*. The IASB decided:

- to require an effective date of 1 January 2013 for all five standards;
- to permit early application provided all five standards are applied at the same time;
- to make it clear that providing some of the disclosure requirements in IFRS 12 would not compel an entity to comply with all of IFRS 12 or to adopt IFRS 10, IFRS 11, IAS 27 (2011) and IAS 28 (2011) early; and

- not to change its previous tentative decisions regarding the transition requirements in IFRS 10 and IFRS 11.

Financial instruments project

The Boards decided tentatively that *write-off* would be defined as 'a direct reduction of the amortised cost of a financial asset resulting from uncollectibility'. In addition, it would be indicated in the standard that a financial asset is considered uncollectible if the entity has no reasonable expectation of recovery. It also would be indicated that an entity writes off a financial asset or part of a financial asset in the period in which the entity has no reasonable expectation of recovery of such asset.

The IASB also decided tentatively to require an entity to disclose:

- its write-off policy, including:
  - discussion related to whether assets written off are still subject to enforcement activity;
  - the nominal amount of assets written off, but for which the entity is still pursuing collection; and
  - recoveries of assets that were written off previously as a separate line item in the reconciliation of changes in the allowance account; and
- the credit quality of assets, including a reconciliation of changes in non-performing financial assets during the period for assets that are 90 days past due but not included in the 'bad book'.

The IASB decided tentatively to remove previously proposed disclosure requirement for:

- stress testing information when an entity prepares such information for internal risk management purposes; and
- information showing the year of origination and the year of maturity, i.e. vintage information.

Insurance contract project

The Boards deliberated on the following topics:

- project axioms and assumptions;
- discount rates for non-participating contracts;
- cash flows included in measuring insurance contracts;
- explicit risk adjustment; and
- day one gains and losses.

The following are some of the key results of the discussion.

- The Boards decided to deliberate jointly on a replacement accounting standard for insurance contracts.
- The IASB will work towards a June 2011 target for the issuance of a future standard on insurance contracts.
- The IASB members confirmed that the existing chapters of IFRS 9 *Financial Instruments* would not be re-opened as part of the insurance contracts project.
- The Boards decided tentatively not to prescribe a method for determining the discount rate but to allow different methodologies that meet the discount rate objective.
- The Boards made other tentative decisions to refine the measurement guidance on cash flows and provide further clarification on costs included in measurement.
- The Boards plan to deliberate in March 2011 on key proposals for scope, recognition, contract boundaries, discounting, risk margins, acquisition costs, unbundling and presentation.

In addition, the Boards also held educational sessions on the treatment of the residual margin, alternative presentation models and unbundling.

Refer *IFRS – Insurance Newsletter Issue 12* for more details.

Leases project

The Boards discussed key issues common to lessee and lessor accounting including the definition of a lease, types of leases, lease term, variable lease payments and other lease payment considerations.

In deliberating the definition of a lease, the Boards expressed support for:

- defining a specified asset as 'an asset of a particular specification';
- clarifying that both physical and non-physical portions of larger assets can be specified assets; and
- creating a revised description of control that is aligned with the proposals in the revenue exposure draft.

The Boards will conduct outreach activities to seek feedback on these components of a proposed new definition of a lease as well as an alternative presented by the staff.

The Boards' other tentative decisions include that:

- there would be two types of leases: finance leases and other-than-finance leases;
- the lease term would be the contractual minimum lease term plus any optional period for which there is a significant economic incentive to renew; and
- an entity would, for contingent rentals on initial recognition:
  - recognise all contingent rentals that are based on an index or rate using spot rates at inception of the lease;
  - recognise all other contingent rentals but use a high recognition threshold, e.g. reasonably certain; the exact definition of that threshold to be determined; and
  - apply anti-avoidance measures designed to capture minimum lease payments that are 'disguised' as contingent rentals that would not otherwise be recognised.

Refer *IFRS – Leases Newsletter Issue 3* for more details.

Post-employment benefits project

The IASB continued its redeliberations of the exposure draft on defined benefit plans and focused specifically on:

- classification of post-employment benefit plans;
- accounting for risk-sharing features in defined benefit plans;
- presentation of remeasurements;
- disclosure and administration costs; and
- effective date and transition requirements.

Classification of post-employment benefit plans

The IASB decided tentatively to clarify that for a plan with a benefit formula to be classified as a defined benefit plan, the benefit formula needs to give rise to a legal or constructive obligation that may require the employer to pay additional contributions as a result of current or past service beyond any contributions already paid for that service.

Accounting for risk-sharing features in defined benefit plans

The IASB decided tentatively:

- to clarify that the benefit to be attributed in accordance with paragraph 67 of IAS 19 *Employee Benefits* is the benefit net of the effect of the employee contributions;
- to confirm the proposal that the effect of employee contributions should be deducted in determining the defined benefit obligation, but to withdraw the proposal that the effect always should be presented as a reduction in service cost;
- to clarify that the conditional indexation should be reflected in the measurement of the defined benefit obligation, regardless of whether the indexation or changes in benefits are automatic or are subject to a decision;
- to clarify that if any limits exist on the legal and constructive obligation to pay additional contributions, then the effect of those limits should be included in the calculation of the defined benefit obligation; and
- to confirm the proposal that the assumptions used to estimate conditional indexation or changes in benefits should be compatible with the other assumptions used to determine the defined benefit obligation.

Presentation of remeasurements

The IASB had decided tentatively in its previous meeting to allow an entity to present remeasurement in profit or loss but with some restrictions, such as making the election irrevocable, and was expected to assess whether the option should be restricted further. In the February 2011 meeting the IASB decided to revert to the original proposal in the exposure draft that remeasurements should be presented in other comprehensive income. Seven members out of 15 would have preferred either to confirm the decision reached in the previous meeting or to allow a free choice.

Disclosure and administration costs

Based on the feedback from the Employee Benefits Working Group on the IASB's tentative decisions regarding disclosure and administration costs, the IASB decided tentatively that:

- disclosure of the weighted-average duration of the defined benefit obligation would be required;
- the amendments to IAS 19 should include examples of the types of additional information that could be provided about the maturity analysis to meet the disclosure objective; and
- administration costs related to the management of plan assets should be deducted from the return on plan assets.

The IASB also decided not to proceed with a requirement to disclose a disaggregation of the defined benefit obligation but instead to include an example of the type of disclosure that may meet the disclosure objectives.

Effective date and transition requirements

The IASB decided to defer its decision on the effective date but agreed tentatively that it should not be earlier than 1 January 2013. The IASB will discuss the effective date as well as early application as part of the broader consideration of the feedback received on the request for views on effective dates and transition methods. Subject to the broader consideration of transition, the IASB decided tentatively:

- for entities already applying IFRSs, that the amendments to IAS 19 would be applied retrospectively in accordance with the general requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except that:
  - the carrying amount of assets outside the scope of IAS 19 need not be adjusted for changes in employee benefit costs that were included in the carrying amount before the beginning of the financial year in which this standard is first applied; and
  - comparatives need not be presented for the disclosures about the sensitivity of the defined benefit obligation for the year of initial application of the amendments to IAS 19;
- for entities adopting IFRSs for the first time, that the amendments to IAS 19 would be applied retrospectively in accordance with the general requirements of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, except that for entities adopting IFRSs with a date of transition to IFRSs before the effective date of the amendments to IAS 19, comparatives need not be presented for the disclosures about the sensitivity of the defined benefit obligation; and
- to confirm the proposal in the exposure draft issued in 2010 to remove paragraphs 153 – 156 of IAS 19 and paragraph D10 of IFRS 1.

The IASB is expected to issue the amendments to IAS 19 by the end of March 2011.

Revenue recognition project

The Boards continued their redeliberations of the exposure draft on revenue from contracts with customers and focused specifically on:

- accounting for warranties;
- identification of separate performance obligations;
- revenue recognition for services;
- combining contracts;
- accounting for contract modifications;
- breakage and prepayments for future goods or services; and
- other issues.

Accounting for warranties

The Boards decided that:

- if a customer has the option to purchase a warranty separately from the entity, then the entity should account for the warranty as a separate performance obligation; the entity would allocate revenue to the warranty service; and
- if a customer does not have the option to purchase a warranty separately from the entity, then the entity should account for the warranty as a cost accrual unless the warranty provides a service to the customer in addition to assurance that the entity's past performance was as specified in the contract in which case the entity would account for the warranty service as a separate performance obligation.

Identification of separate performance obligations

The Boards decided tentatively that:

- an entity should account for a bundle of promised goods or services as one performance obligation if the entity provides a service that integrates those goods or services into a single item; and
- an entity should account for a promised good or service as a separate performance obligation if the pattern of transfer of the good or service is different from that of other promised goods or services in the contract, and the good or service has a distinct function.

A good or service has a distinct function if either the entity regularly sells the good or service separately, or the customer can use the good or service either on its own or together with resources that are readily available to the customer.

Revenue recognition for services

The Boards decided tentatively that to recognise revenue for a service, an entity must determine that a performance obligation is satisfied continuously and then must select a method for measuring progress toward complete satisfaction of that performance obligation. The Boards decided tentatively that an entity satisfies a performance obligation continuously if at least one of the following two criteria is met:

- the entity's performance creates or enhances an asset that the customer controls as the asset is being created or enhanced; or
- the entity's performance does not create an asset with an alternative use to the entity and at least one of the following conditions is met:
  - the customer receives a benefit as the entity performs each task;
  - another entity would not need to reperform the task(s) performed to date if that other entity were to fulfil the remaining obligation to the customer; or
  - the entity has a right to payment for performance to date even if the customer could cancel the contract for convenience.

The Boards decided tentatively that the final revenue standard should:

- emphasise that the objective of measuring progress is to depict faithfully the entity's performance, i.e. the pattern of transfer of goods or services to a customer; and
- clarify the descriptions in the exposure draft of output and input methods.

The Boards decided tentatively that if an entity merely procures goods that are transferred at a different time from related services, e.g. materials that the customer controls before the entity installs the materials, then the entity should measure progress by recognising revenue for the transfer of those goods in an amount equal to the costs of the transferred goods.

Combining contracts

The Boards decided tentatively that an entity should combine two or more contracts that are entered into at or near the same time with the same customer or related entities if one or more of the following criteria are met:

- the contracts are negotiated as a package with a single commercial objective;
- the amount of consideration in one contract depends on the other contract; and
- the goods and services in the contracts are interrelated in terms of design, technology or function.

Accounting for contract modifications

The Boards decided tentatively that if a contract modification results only in the addition of a separate performance obligation or obligations at a price that is commensurate with that additional performance obligation, then the entity should account for the contract modification as a separate contract. Otherwise, the entity should re-evaluate the performance obligation and reallocate the transaction price to each separate performance obligation.

Breakage and prepayments for future goods or services

The Boards discussed the accounting for a customer's non-refundable prepayment for future goods or services and the portion of the customer's rights that is not exercised, which is often referred to as breakage. The Boards decided tentatively that if an entity can estimate reasonably the amount of expected breakage, then the entity should recognise the effects of the expected breakage as revenue in proportion to the pattern of rights exercised by the customer. Otherwise, the entity should recognise the effects of the expected breakage when the likelihood of the customer exercising its remaining rights becomes remote.

Other issues

The Boards decided tentatively that:

- an entity should recognise an asset for the incremental costs of obtaining a contract that the entity expects to recover;
- an asset recognised for the costs of obtaining a contract should be presented separately in the statement of financial position and subsequently be amortised on a systematic basis consistent with the entity's performance under the contract(s) to which the asset relates; and
- the unit of account for the test to assess whether performance obligations are onerous should be the contract, specifically the remaining performance obligations in the contract.

The Boards also decided to amend the definition of a performance obligation by removing the word 'enforceable'.

Abbreviations

1 IASB: International Accounting Standards Board

2 FASB: US Financial Accounting Standards Board

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