June 2011 IASB meetings

Highlights:

- IASB and FASB support different approaches for offsetting financial assets and financial liabilities; agree to work on converging disclosure requirements
- 'Three-bucket' approach on the basis of credit risk deterioration for impairment of financial assets
- Accounting for subleases and short-term leases clarified
- Boards agree to re-expose revised proposals for revenue recognition
- 120-day comment period for the annual improvements exposure draft

The summary below combines the outcomes of the individual sessions from the IASB's[1] meetings held on 13–15 June 2011. In a number of sessions the IASB held joint discussions with the FASB[2]. The following projects were discussed:

- financial asset and financial liability offsetting
- financial instruments: impairment
- insurance contracts
- leases
- revenue recognition.

The IASB and the FASB (the Boards) also had education sessions on tentative decisions made by the FASB on classification and measurement of financial instruments and its investment properties project.

The IASB separately discussed the proposed timing of the forthcoming agenda consultation, the comment period for the exposure draft on improvements to IFRSs and sweep issues related to the exposure draft on investment entities.

Financial asset and financial liability offsetting project

The Boards discussed the following alternative approaches for requiring the offsetting of financial assets and financial liabilities on the statement of financial position.

- Approach 1 would require a right of set-off that is exercisable both in the normal course of business and in bankruptcy, insolvency or default and intention to settle a financial asset and financial liability net or simultaneously.

- Approach 2 would require a right of set-off that is legally enforceable in the normal course of business and intention to settle a financial asset and financial liability net or simultaneously.
- Approach 3 would provide an exception to the general offsetting criteria for derivatives, which allows offsetting of derivatives and related collateral. In such cases, approach 3 would require a right of set-off that is only enforceable in bankruptcy, insolvency or default of one of the counterparties.

The IASB members unanimously supported approach 1; the majority of the FASB members supported approach 3. The Boards agreed to work on converging disclosure requirements that would assist users in reconciling any differences in the offsetting requirements between IFRSs and US GAAP.

Financial instruments project: impairment

The Boards discussed a 'three-bucket' expected loss approach for the impairment of financial assets.

The three-bucket approach reflects the general pattern of deterioration of credit quality of loans. Allowance balances would be determined by the different phases of the deterioration in credit quality for all financial assets subject to impairment accounting. Generally, the three-bucket approach would encompass the following.

- Bucket 1 would include, in the context of portfolios, assets evaluated collectively for impairment that do not meet the criteria of Buckets 2 or 3, including loans with changes in credit loss expectations as a result of macroeconomic events that are not particular to either a group of loans or a specific loan.
- Bucket 2 would include assets affected by the occurrence of events that indicate a direct relationship to possible future defaults, although the specific assets with possible future default have not yet been identified.
- Bucket 3 would include assets for which information is available that specifically identifies that credit losses are expected to occur, or have occurred, on individual assets.

The Boards decided to continue to develop the three-bucket approach that distinguishes the buckets on the basis of credit risk deterioration. The Boards tentatively decided that the allowance balance of Buckets 2 and 3 should be the remaining lifetime expected loss estimate.

The Boards are expected to:

- consider how to operationalise an approach for Bucket 1 with an overall objective of recognising an impairment allowance for losses initially expected in the next 12 months and the full amount of any changes in expected credit losses; and
- further develop criteria to determine to which of the three buckets the financial assets should be attributed.

Insurance contracts project

During June the discussions mainly focused on:

- whether to unlock the residual margin;
- how to unlock the residual margin;
- allocation of the residual margin;
- acquisition costs; and
- presentation of the statement of comprehensive income.

Key points to note are:

- the IASB agreed to unlock the residual margin prospectively for changes in assumptions on future cash flows;
- the IASB agreed that the residual margin would be recognised over the coverage period based on the transfer of services;
- the Boards agreed on the types of acquisition costs to be included in the measurement of the insurance liability, while a difference remains on the inclusion of costs for unsuccessful efforts; and
- the Boards considered alternative presentations for the statement of comprehensive income.

Refer to *IFRS – Insurance Newsletter* Issue 18 for more details.

Leases project

The Boards discussed lessor accounting, subleases and short-term leases. The Boards also discussed the accounting implications of applying a right-of-use lease model to Shariah-compliant lease contracts; no decisions were made.

Lessor accounting

The Boards discussed a single approach to lessor accounting under a right-of-use model that would require the lessor to recognise a lease receivable and a residual asset at lease commencement.

The Boards are expected to consider at a future meeting:

- whether, and if so when, it is appropriate for a lessor to recognise profit at lease commencement under the above approach; and
- whether there should be different lessor models for a lease of a portion of an asset and a lease of an entire asset.

Subleases

The Boards discussed the accounting for subleases under the proposed requirements for lessees and lessors and tentatively decided that:

- a head lease and a sublease should be accounted for as separate transactions;
- an intermediate lessor, as a lessee in a head lease arrangement, should account for its assets and liabilities arising from the head lease in accordance with the decisions to date for all lessees;
- an intermediate lessor, as a lessor in a sublease arrangement, should account for its assets and liabilities arising from the sublease in accordance with the decisions to date for all lessors; and
- if there should be more than one approach to lessor accounting, then an intermediate lessor, as a lessor in a sublease, should evaluate its right-of-use asset, not the underlying asset, to determine the appropriate lessor accounting approach to apply to the sublease.

Short-term leases

The Boards discussed lessee accounting for short-term leases. A short-term lease is defined as a lease that, at the date of commencement of the lease, has a maximum possible term, including any options to renew, of 12 months or less.

The Boards tentatively decided that a lessee of short-term leases may elect not to recognise lease assets or lease liabilities in which case it should recognise lease payments in profit or loss on a straight-line basis over the lease term. Another systematic and rational basis for recognising lease payments may be applied only if it is more representative of the time pattern in which use is derived from the underlying asset.

The Boards also tentatively decided that a lessee of short-term leases may elect to apply the recognition and measurement requirements in the leases guidance.

The Boards expressed support for requiring disclosure of the rental expense recognised in the current period and the extent to which that expense is expected to be representative of rental expense in future periods.

The Boards are expected to discuss disclosures and lessor accounting for short-term leases at a future meeting.

Revenue recognition project

The Boards completed their planned redeliberations of the exposure draft on revenue from contracts with customers by discussing the following topics:

- the effect of the proposed standard on telecommunications and other entities;
- the transitional requirements for the proposed standard; and
- re-exposure of the proposed standard.

Effect on telecommunications and other entities

The Boards discussed concerns raised by constituents in the telecommunications industry about the effect of the proposed standard and tentatively decided not to revise the proposed requirements.

Transitional requirements

The Boards tentatively affirmed the retrospective application of the proposed requirements. However, the Boards tentatively decided to provide transitional reliefs that an entity, in the first year of application:

- should not be required to restate contracts that begin and end within the same reporting period;
- should be permitted to use hindsight in estimating variable consideration in the comparative reporting periods;
- should be required to perform the onerous test only at the effective date unless an onerous contract liability was recognised previously in a comparative period; and
- should not be required to disclose the maturity analyses of remaining performance for prior periods.

The Boards tentatively decided that if an entity employs any of the transitional reliefs above, then the entity should apply that to all transactions throughout the comparative periods and disclose the following information:

- the reliefs that have been employed by the entity; and
- a qualitative assessment of the likely effect of applying those reliefs, to the extent possible.

Re-exposure of the proposed standard

The Boards agreed to re-expose their revised proposals for a common revenue recognition standard that incorporate revisions undertaken by the Boards on the exposure draft issued in June 2010. Specifically, the Boards plan to invite feedback on:

- the extent to which the revised requirements are understandable;
- whether the drafting of the requirements has not created unintended consequences for specific contracts or industries; and
- a few specific aspects of the revised requirements.

The Boards intend to re-expose their revised proposals in the third quarter of 2011 for 120 days.

Other projects or issues discussed

Proposed timing of the forthcoming agenda consultation

The IASB considered the proposed timing of the forthcoming agenda consultation and tentatively agreed to launch the consultation in July after discussion of the consultation plans with the IFRS Advisory Council and the Trustees of the IFRS Foundation. The IASB tentatively agreed to a deadline of 30 November 2011 for comments on the agenda consultation.

Comment period for the exposure draft on improvements to IFRSs

The IASB reviewed its previous decision on the comment period for this particular exposure draft and decided that it should be lengthened to 120 days.

The exposure draft was issued on 22 June 2011; refer to *In the Headlines* Issue 2011/22.

Exposure draft on investment entities

The IASB discussed two sweep issues with respect to publishing the exposure draft on investment entities. The IASB agreed that the exposure draft should have a comment period of not less than 120 days.

Abbreviations

1 IASB: International Accounting Standards Board

2 FASB: US Financial Accounting Standards Board

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