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IN THE HEADLINES
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July 2011 IASB meetings

The summary below combines the outcomes of the individual sessions from the IASB's[1] meetings held on 20–22 and 28 July 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: hedge accounting
- financial instruments: impairment
- insurance contracts
- leases
- revenue recognition.

In addition, the IASB and the FASB (the Boards) discussed effective dates and transition methods of key projects, and had an education session on the report from the working group who considered how the level of disclosures required by IFRSs could be reduced.

The IASB separately discussed the agenda consultation that was issued on 26 July 2011; refer to *In the Headlines* Issue 2011/25.

The IASB also received an update from the July 2011 meeting of the IFRS Interpretations Committee.

Financial asset and financial liability offsetting project

The Boards discussed the proposed offsetting disclosures and tentatively decided to:

- retain the objective for the offsetting disclosures as proposed in the exposure draft;
- limit the scope of the proposed disclosure requirements to instruments under an enforceable master netting agreement or similar arrangement (e.g. derivatives,

Highlights:

- Existing offsetting requirements in IAS 32 to be retained
- Revised joint disclosure requirements for offsetting financial assets and financial liabilities
- 'Relative' credit risk model based on credit risk management system for the impairment of financial assets
- Boards agree to re-expose proposals for lease accounting
- Lessors to apply a single 'receivable and residual' model
- Effective date of IFRS 9 to be delayed to 1 January 2015

sale and repurchase agreements, reverse sale and repurchase agreements, securities lending arrangements); and

- clarify that offsetting disclosures are not required if an entity has no qualifying assets or liabilities that are subject to a right of set-off (other than collateral agreements) at the reporting date.

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

(a) the gross amounts of financial assets and financial liabilities;

(b) the amounts of financial assets and financial liabilities offset in the statement of financial position;

(c) the net amount after taking in account (a) and (b), which should be the same as the amounts reported in the statement of financial position;

(d) the effect of rights of set-off that are only enforceable and exercisable in bankruptcy, default or insolvency of either party that are not reflected in the amounts presented in the statement of financial position (including collateral); and

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

Following the joint discussion on different offsetting approaches in the previous meeting, the IASB separately discussed whether to retain the existing offsetting requirements in IAS 32 *Financial Instruments: Presentation* or to pursue turning the exposure draft into a final standard. Although a majority preferred to retain the existing offsetting requirements in IAS 32, the IASB will discuss further whether and how inconsistencies in the application of the existing offsetting requirements should be addressed.

Financial instruments project: hedge accounting

The IASB continued its redeliberations on the exposure draft on hedge accounting and discussed:

- accounting for forward points
- aggregated exposures
- net position cash flow hedges
- net presentation in a separate line item in the income statement
- risk components
- hedges of credit risk using credit derivatives
- disclosure requirements
- linked presentation
- contracts to buy or sell non-financial items that can be settled net in cash.

Accounting for forward points

The IASB discussed whether the proposals in the exposure draft for the time value of options should be extended to forward points, as requested by respondents to the exposure draft. The IASB tentatively decided to permit forward points that exist at inception of the hedging relationship to be recognised in profit or loss over time on a rational basis and to accumulate subsequent fair value changes in accumulated other comprehensive income. The purpose is to provide a better representation of the economic substance of the funding swap transaction and the performance of the net interest margin.

Aggregated exposures

The IASB discussed the feedback on the designation of an aggregated exposure as the hedged item. The feedback supported the proposals under which an aggregated exposure that is managed as one exposure for a particular risk (or risks) may be designated as a hedged item.

The IASB tentatively decided:

- to confirm the proposal;
- to provide illustrative examples that will accompany the final standard;
- to clarify explicitly in the final standard that the proposal does not allow 'synthetic accounting';
- not to impose any specific restrictions (e.g. requiring that hedge accounting should be achieved) as a precondition for the aggregated exposure being eligible as the hedged item;
- to explain how aggregated exposures relate to forecast transactions; and
- to add application guidance on how to apply the general requirement in the context of aggregated exposures.

Net position cash flow hedges

The IASB discussed the feedback on the criteria for the eligibility of groups of items as a hedged item. The feedback supported the proposals that would facilitate hedge accounting for groups and net positions.

The IASB tentatively decided that cash flow hedges of net positions would be available only for hedges of foreign currency risk. The IASB also tentatively decided to remove the restriction that the offsetting cash flows in a net position must affect the income statement in the same reporting period. Instead, the eligibility criteria would be extended to require that the items within the net position must be specified in such a way that the pattern of how they will affect the income statement is set out as part of the initial hedge designation.

Net presentation in a separate line item in the income statement

The IASB discussed the positive feedback on the proposal to present the gains and losses on the hedging instrument as a separate line item in the income statement for net position hedges.

The IASB tentatively confirmed the proposals and that the separate line item for hedging gains and losses also includes the gains and losses on forecast transactions deferred to later periods.

Risk components

Although many respondents asked for additional guidance, the feedback on the designation of a risk component as the hedged item was positive.

The IASB discussed the feedback and tentatively decided:

- to retain the notion of risk components as eligible hedged items;
- to use a criteria-based approach to determining eligible risk components on the basis of the criteria in the exposure draft that a risk component must be separately identifiable and reliably measurable;
- to use a single set of criteria for all items (financial and non-financial items); and
- to provide guidance by using examples to illustrate how the criteria should be applied.

The IASB also discussed the specific restriction in the exposure draft that prohibits designating non-contractually specified inflation risk components of financial items as a hedged item. The IASB tentatively decided:

- to eliminate the restriction but add a 'caution' and 'rebuttable presumption' regarding non-contractually specified inflation risk components of financial items; and
- to include an example of a situation in which an inflation risk component is an eligible risk component and *vice versa*.

Hedges of credit risk using credit derivatives

The IASB discussed the feedback on hedges of credit risk using credit derivatives and tentatively decided to explore an approach reflecting the insurance like nature of credit derivatives that are used to manage credit exposures.

Disclosure requirements

The IASB discussed the following issues related to the proposed disclosure requirements:

- scope of the hedge accounting disclosures
- description of the risk management strategy
- timing, amount and uncertainty of future cash flows
- effects of hedge accounting on the financial statements.

Scope of the hedge accounting disclosures

The IASB tentatively confirmed the scope of the hedge accounting disclosures in the exposure draft to require disclosure of information on risk exposures being hedged and for which hedge accounting is applied.

Description of the risk management strategy

The IASB tentatively decided to add guidance on the description of the risk management strategy under each risk category, which includes:

- whether the entity hedges an item in its entirety for all risks or hedges a risk component of an item, how each risk arises and why it uses that particular approach;
- the hedging instruments that are used to offset the risk exposure and how they are used;
- how the entity determines the economic relationship between the hedged item and the hedging instrument for the purpose of testing hedge effectiveness;
- how the entity establishes the hedge ratio; and
- the sources of hedge ineffectiveness.

The IASB also tentatively decided that an entity should provide qualitative or quantitative information that allows users to understand:

- how the entity determined the component that is designated as the hedged item; and
- how the component relates to the item in its entirety.

Timing, amount and uncertainty of future cash flows

The IASB noted the concerns that the proposed disclosure requirements regarding the timing, amount and uncertainty of future cash flows would lead to disclosure of commercially sensitive information. Therefore, instead of requiring such disclosures, the IASB tentatively decided to require an entity to disclose information that would allow users to understand:

- the principal, stated face or similar amount (referred to as the notional amount) of the hedging instrument;
- a profile of the timing of the notional amount of the hedging instrument based on the terms of that instrument; and
- if applicable, the average price or rate (for example strike or forward prices) of the hedging instrument.

Effects of hedge accounting on the financial statements

The IASB tentatively decided:

- to require an entity to disclose the change in fair value of both the hedged items and hedging instruments that are used to determine the hedge ineffectiveness, which would be linked to the hedge ineffectiveness recognised in the statement of profit or loss and other comprehensive income;
- to require an entity to provide the same level of aggregation or disaggregation of information for the purpose of the hedge accounting disclosure as it does for other disclosures in IFRS 7 *Financial Instruments: Disclosures* and IFRS 13 *Fair Value Measurement*; and
- not to require a disclosure that distinguishes the carrying amount of financial instruments that have been designated as hedging instruments and those that have not.

Linked presentation

After having conducted outreach activities the IASB tentatively decided to confirm its previous decision not to allow linked presentation for fair value hedges.

Contracts to buy or sell non-financial items that can be settled net in cash

The IASB discussed the feedback on the proposal in the exposure draft to change the accounting for a contract to buy or sell a non-financial item that can be settled net in cash (so-called 'own use' contracts). In response to the concern about unintended consequences that might create an accounting mismatch in some situations, the IASB tentatively decided to extend the fair value option in IFRS 9 *Financial Instruments* to contracts that meet the 'own use' scope exception instead of using the proposal in the exposure draft.

Financial instruments project: impairment

The Boards discussed an approach to expected losses for the impairment of financial assets subject to accounting for impairment (e.g. those measured at amortised cost).

The Boards agreed to develop an approach for classifying and transferring financial assets into and between three categories (or 'buckets') based on credit risk management systems.

The Boards decided to develop the 'relative', instead of 'absolute', credit risk model to reflect the deterioration or improvement in the credit quality of financial assets to make the maximum use of credit risk management practices. Under this approach, all originated and purchased financial assets would initially start in Bucket 1 and will move into Bucket 2 and Bucket 3 as credit loss expectations deteriorate, affecting the uncertainty in collectability of cash flows. Loans acquired at a discount because of credit losses are expected to be addressed at a future meeting.

The Boards agreed to keep the calculation of the impairment allowance for Bucket 1 operationally simple and to explore approaches that would calculate the allowance using 12 or 24 months' worth of losses that are expected to occur. The Boards also agreed that the calculation of 12 months' worth of expected losses in Bucket 1 will be based on 'annual' losses that are expected to occur in the next 12 months rather than 'annualised' losses calculated as the lifetime losses divided by the number of years remaining. The same logic would apply if a 24-month horizon was used.

Insurance contracts project

The Boards received an oral report on recent investor outreach activities and considered when insurers should apply the premium allocation approach to short-duration contracts. No decisions were made.

Leases project

The Boards discussed:

- re-exposure of the proposed standard
- lessor accounting
- lease payments that depend on an index or a rate
- embedded derivatives in lease contracts
- lessee presentation and disclosure.

Key points to note are:

- the proposals will be re-exposed;
- lessors would apply a single 'receivable and residual' model;
- leases of investment properties that are measured at fair value would be out of scope; and
- variable lease payments that are based on an index or rate would be measured at lease commencement and re-assessed.

Refer to *IFRS – Leases Newsletter* Issue 7 for more details.

Revenue recognition project

The IASB tentatively decided that the re-exposure draft would propose relief from retrospective application of four specific requirements. The IASB also tentatively decided to add an exemption to IFRS 1 *First-time Adoption of International Financial Reporting Standards* to permit a first-time adopter to apply any one of the following three reliefs.

- The entity would not be required to apply the proposals to contracts that begin and end within the same annual periods prior to the first IFRS reporting period.
- The entity would be required to use hindsight in estimating variable consideration in the periods prior to the first IFRS reporting period.
- The entity would not be required to disclose the maturity analyses of remaining performance obligations for periods before the first IFRS reporting period.

Effective dates

The Boards discussed the results of additional outreach and whether to permit early application of the standards resulting from the four major projects; financial instruments, insurance, leases and revenue recognition. The IASB decided to permit early application of new IFRSs by first-time adopters of IFRSs. The IASB is expected to consider the issue of early application by other entities on a standard-by-standard basis.

New revenue standard

The Boards tentatively decided that the effective date of the revenue standard would be set to ensure that the start of the earliest comparative period for an entity that is required to present two comparative annual periods (in addition to the current annual period) would be a few months after the standard is issued. Consequently, the Boards noted that the effective date of the revenue standard would not be earlier than annual periods beginning on or after 1 January 2015. The IASB tentatively decided that early application of the revenue standard should be permitted.

IFRS 9

The IASB tentatively decided to change the mandatory effective date of IFRS 9 to annual periods beginning on or after 1 January 2015. It issued an exposure draft to solicit feedback on this proposal on 4 August 2011; refer to *In the Headlines* Issue 2011/26.

Abbreviations

1 IASB: International Accounting Standards Board

2 FASB: US Financial Accounting Standards Board

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