

IFRS in Brief

February 2009, **Issue 54**

This issue of IFRS in Brief covers the January 2009 meeting of the International Accounting Standards Board (IASB or Board).

Highlights

- **Board approves IFRIC 18 *Transfers of Assets from Customers***
- **Board decides not to proceed with Exposure Draft *Investment in Debt Instruments – Proposed amendments to IFRS 7***
- **Exposure drafts on derecognition and fair value measurement anticipated as early as March 2009**
- **Leases discussion paper anticipated in March 2009**
- **Board updates technical plan**

Summary

At its January 2009 meeting the IASB continued discussing the:

- Board's responses to the credit crisis
- annual improvements project
- conceptual framework project
- financial instruments with characteristics of equity project
- issues relating to a proposed IFRS for non-publicly accountable entities (previously *IFRS for Small and Medium-sized Entities*)
- income taxes project
- leases project
- post-employment benefits project.

In addition, at its January 2009 meeting the IASB:

- discussed recent International Financial Reporting Interpretations Committee (IFRIC) activities
- reviewed the technical plan.

Board's Response to the Credit Crisis

The Board discussed the following aspects of its response to the credit crisis:

- derecognition
- fair value measurement
- disclosures of financial instruments.

Derecognition

At its previous meetings, the IASB discussed a derecognition principle for financial assets. The Board tentatively decided in such meetings that, under that principle, an entity should derecognise a financial asset or component thereof when it no longer qualifies as an asset of the entity. As such, derecognition would occur when:

- the economic benefits no longer exist; or
- the economic benefits exist but the entity no longer has the ability to both obtain the future economic benefits inherent in the asset or component, and restrict others' access to those benefits.

The IASB has been discussing two possible approaches to make the derecognition principle operational.

Approach one focuses solely on the transferor's present access, for its own benefit, to the cash flows from the financial asset.

Approach two starts with determining whether the derecognition principle will be applied to the asset in its entirety or a component thereof. As such, a transferor of a financial asset,

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or component, would derecognise it in any of the following circumstances:

- The transferor has no continuing involvement in the financial asset or component.
- The transferee has the practical ability to transfer the financial asset or component to a third party for its own benefit, and is able to exercise that practical ability unilaterally, without imposing additional restrictions on the transfer.

At its January 2009 meeting, the Board continued its discussion of these two possible approaches and made a number of tentative decisions in relation to both approaches. For approach one the Board tentatively decided:

- to modify the derecognition test to focus on whether the transferor presently has access to the cash flows or other future benefits of the financial asset
- that a new asset will be recognised when the transferor:
 - retains a component of a financial asset or group of financial assets in a transfer qualifying for derecognition
 - purchases an investment from a transferee securitisation vehicle.

For approach two the Board made the following tentative decisions:

- For a transfer of a part of a derivative, a hybrid instrument with an embedded derivative that requires bifurcation, or an equity instrument, an entity would assess the *part* (rather than the entire instrument) for derecognition only if it involves specifically identified and / or proportionate cash flows.
- The derecognition test could be applied to a group of transferred financial assets, provided none of those financial assets are instruments that can be either assets or liabilities

over their life, or that involve benefits other than cash flows.

- In a transfer that qualifies for derecognition, “new asset” treatment would not be applied to retained components of transferred financial assets. However, when the transferor purchases an investment from a transferee securitisation vehicle, it will be treated as a new asset.
- For a financial asset that does not qualify for derecognition, the notes, rather than the statement of financial position, would disclose the link between such asset and the associated liability, provided the transferee only has recourse to the transferred asset rather than to the transferor.

The derecognition exposure draft (ED) is expected to be issued in March or April 2009.

Fair Value Measurement

The Board discussed the following matters relating to fair value measurement:

- scope assessment
- fair value disclosures
- day one gains in service contracts
- transitional requirements
- comment period.

Scope Assessment

The Board tentatively decided not to retain the term “fair value” for measurements of share-based payment transactions, reacquired rights in a business combination, and financial liabilities with a demand feature, as the intended measurement objective for such measurements is not the “current exit price”. The IASB staff plans to draft new descriptions that are more commensurate with the measurement objectives in each of these cases.

In addition, the Board tentatively decided to amend IAS 39 *Financial*

Instruments: Recognition and Measurement to specify that for financial instruments that are subsequently measured on a basis other than fair value through profit or loss, an entity would not recognise a gain or loss on initial recognition.

Fair Value Disclosures

The Board tentatively decided that the following disclosures would be required:

- fair value measurements by level of the fair value hierarchy (Level 1, Level 2 or Level 3)
- the methods used for and assumptions applied to the determination of fair value, including changes to valuation techniques
- for Level 3 fair value measurements:
 - a reconciliation from the opening balances to closing balances
 - the amount recognised in profit or loss for gains or losses that relate to assets and liabilities held at the end of the reporting period
 - a sensitivity analysis.

Day One Gains in Service Contracts

For service contracts, the Board discussed the presumption that generally the transaction price is the best evidence of fair value at initial recognition of an asset or liability. The Board tentatively decided that the secondary (wholesale) market with other service providers is the only true exit market for the service provider.

With respect to the exit price for the service provider, the Board tentatively decided that this exit price:

- should reflect the perspective of the service provider rather than the perspective of the customer
- is likely to differ at initial recognition from the transaction price, since the service provider will typically price the transaction to cover costs and provide a reasonable return.

Transitional Requirements

The Board tentatively decided that an entity that previously deferred the recognition of any gain or loss on initial recognition of a financial instrument classified at fair value through profit or loss would adjust retained earnings retrospectively on initial application of the proposed IFRS. In all other respects, the proposed measurement requirements would be applied prospectively. An entity would not need to provide the proposed disclosure requirements for periods before it initially applies the IFRS.

Comment Period

The Board expects that the fair value measurement ED would:

- have a 120-day comment period
- be issued around the end of March 2009.

Disclosures of Financial Instruments

In October 2008 the IASB issued an ED *Improving Disclosures about Financial Instruments – Proposed amendments to IFRS 7*. The Board discussed the responses to the ED and tentatively decided to retain the proposals in the ED that require:

- a three-level fair value disclosure hierarchy
- disclosure of separate maturity analyses for derivative and non-derivative financial liabilities
- summary data about each type of risk that arises from financial instruments, based on information that is provided internally to key management personnel
- minimum contractual liquidity risk disclosures for non-derivative financial liabilities.

The Board tentatively decided to retain the proposal in the ED which would not require existing minimum contractual liquidity risk disclosures for some types of derivative financial liabilities.

The Board also tentatively decided:

- to use the same hierarchy as in U.S. Statement of Financial Accounting Standard 157 *Fair Value Measurements* issued by the U.S. Financial Accounting Standards Board (FASB)
- not to require disclosures about the fair value hierarchy for financial instruments that are not measured at fair value.

The Board anticipates that the final amendments will be applicable for annual periods beginning on or after 1 January 2009, with earlier application permitted; comparative disclosures on transition would not be required.

The Board also discussed responses to the ED *Investments in Debt Instruments – Proposed amendments to IFRS 7* that was published in December 2008. The Board decided not to proceed with the proposed amendments at this time, but would consider such proposed amendments in its broader project on improving the accounting for financial instruments.

Annual Improvements Project

The Board plans to issue in April 2009 the second improvements to IFRSs, the majority of which are based on the ED that was published in August 2008. Two amendments that were proposed in the ED will be deferred to the next annual improvements cycle.

Conceptual Framework Project

The Board discussed phases A, C and D of the conceptual framework project. With respect to phase A, about the objective and qualitative characteristics of financial reporting, the Board tentatively reconfirmed a number of previously made proposals. With respect to phase C, about measurement in financial reporting, the Board did not make any decisions.

With respect to phase D, about the reporting entity, the Board discussed responses to the discussion paper (DP) *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*. The Board tentatively decided:

- to revise the description of a reporting entity to “a circumscribed area of economic activity whose financial information has the potential to be useful to present and potential equity investors, lenders and other capital providers for decisions in their capacity as capital providers”
- to clarify that even an inactive entity can be a reporting entity
- that a reporting entity does not have to be a legal entity
- that a legal entity or a branch or segment of a legal entity could, but would not necessarily, meet the description of a reporting entity.

With respect to group reporting entities, the Board tentatively decided that:

- if a reporting entity controls other entities, then consolidated financial statements using the controlling entity model would be presented
- if the controlling entity is not a reporting entity, then combined financial statements would be useful
- parent-only financial statements may provide useful information in combination with consolidated financial statements, but they should not be mandatory.

Financial Instruments with Characteristics of Equity Project

The Board discussed the classification of puttable and mandatorily redeemable instruments, as well as the conceptual definitions of a liability and equity, with no decisions made.

Issues Relating to a Proposed IFRS for Non-publicly Accountable Entities

The Board tentatively decided that the name of the proposed *IFRS for Small and Medium-sized Entities* would be International Financial Reporting Standard for Non-publicly Accountable Entities (IFRS for NPAEs).

Furthermore, the Board made the following tentative decisions:

- If an NPAE can measure the fair value of an item of investment property reliably and without undue cost or effort, then it uses the fair value model; otherwise, it uses the cost model.
- For property, plant and equipment and intangible assets, the revaluation model would not be an option.
- All borrowing costs and development costs would be recognised as an expense; capitalisation would not be allowed.
- With respect to the cash flow statement, NPAEs could use either the indirect or the direct method.
- An NPAE could apply either Section 11 of the IFRS for NPAEs, or all requirements of full IFRSs with respect to the accounting for financial instruments; this is anticipated to be the only cross-reference to full IFRSs.
- As proposed in the ED, the cost method, equity method, and fair value through profit or loss method would all be allowed for the accounting for associates and jointly-controlled entities. Contrary to the ED, proportionate consolidation of jointly-controlled entities would not be permitted.
- Goodwill and other indefinite-life intangible assets would be accounted for as if they have definite lives; such assets would be amortised with a maximum amortisation period of 10 years and be assessed, as proposed in the ED,

for impairment using the “indicator approach”.

- All NPAE groups will be required to prepare consolidated financial statements, with some exceptions, as proposed in the ED.

Income Taxes Project

The Board tentatively decided that the ED on income tax would be silent as to whether entities should discount current tax that is refundable or payable.

Leases Project

The IASB and the FASB (the Boards) discussed the content and timing of the proposed DP on lease accounting in a joint video conference meeting. The Boards plan to include in the DP a high-level discussion of lessor accounting issues and issue the DP in March 2009. The IASB also tentatively decided that the scope would not be changed to exclude contracts that are “in-substance purchases”.

Post-employment Benefits Project

The Board tentatively decided that the proposals in the DP *Preliminary Views on Amendments to IAS 19 Employee Benefits* would be addressed in two EDs, as follows:

- The first ED would address recognition, presentation and disclosure aspects of defined benefit plans and other issues that could be addressed quickly.
- The second ED would address contribution-based promises, potentially as part of a comprehensive review of pension accounting (the second phase).

For the first ED the Board made the following tentative decisions:

- Entities would disaggregate changes in the defined benefit obligation and plan assets into employment, financing and remeasurement

components, and recognise such components in profit or loss.

- The employment and financing components would be disclosed either in profit or loss or in the notes, with a requirement for the remeasurement component to be presented in profit or loss in such a way that it can be distinguished from other items of profit or loss.

Recent International Financial Reporting Interpretations Committee (IFRIC) Activities

IFRIC 18 *Transfers of Assets from Customers*

The Board approved IFRIC 18 and decided that an entity should apply this interpretation prospectively to transfers of assets received from customers on or after 1 July 2009; an entity would be allowed to apply IFRIC 18 earlier if it obtained the valuations and other information needed to apply the interpretation to past transfers at the time those transfers occurred.

IFRIC 9 *Reassessment of Embedded Derivatives*

The Board decided to propose an amendment to paragraph 5 of IFRIC 9 to exclude from its scope embedded derivatives in contracts acquired in:

- combinations of entities or businesses under common control
- the formation of joint ventures.

The ED, issued in January 2009, has a 30-day comment period.

IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*

The Board decided to propose an amendment to IFRIC 16 to remove the restriction that prevents a hedging instrument from being held by the foreign operation that is itself being hedged.

The ED, issued in January 2009, has a 30-day comment period.

IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

The Board considered a proposal to eliminate an unintended consequence of the guidance in IFRIC 14 with respect to the treatment of voluntary prepayments when a defined benefit plan also is subject to a minimum funding requirement.

The Board tentatively decided to amend IFRIC 14 so that an entity recognises an asset for voluntary prepayments that would reduce future contributions payable by the entity.

Technical Plan

The Board discussed its updated technical plan and project timetables, which are available on the IASB Web site.

IASB Observer Notes

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