KPMG
cutting through complexity

IN THE HEADLINES
October 2011, Issue 2011/32

September 2011 IASB meetings

The summary below combines the outcomes of the individual sessions from the IASB's[1] meetings held on 19–21 September 2011. In some sessions the IASB held joint discussions with the FASB[2]. The IASB also received an update from the September 2011 meeting of the IFRS Interpretations Committee.

Highlights

- Inconsistencies in application guidance in IAS 32 to be removed
- Dynamic hedging relationships to be exempt from certain disclosure requirements
- First-time adopters to have same prospective application provisions as existing preparers
- No limit to available techniques for insurance risk adjustment; confidence level equivalent disclosure retained
- Fair value measurement of right to receive lease payments prohibited

Annual improvements

The IASB discussed eight issues recommended by the IFRS Interpretations Committee for inclusion in the next *Improvements to IFRSs* exposure draft (ED) (2010/12 cycle), which is expected to be issued in November 2011.

IFRS 2 *Share-based Payment*: Vesting and non-vesting conditions

The IFRS Interpretations Committee proposed amending the definitions of 'performance conditions' and 'service conditions'. The amendment would clarify that:

- a performance target is defined by reference to the entity's own operations or activities;

Topics discussed

- a performance target may relate either to the performance of the entity as a whole or to that of a part, such as a division or an individual employee;
- to constitute a performance condition, a performance target needs to have an explicit or implicit service requirement for the duration of the period for which the performance target is being measured; and
- if the employee fails to complete a specified service period, then the employee fails to satisfy a service condition regardless of the reason for failure.

The IASB tentatively decided to include the proposed amendment in the next ED.

IFRS 8 *Operating Segments*: Reconciliation of the reportable segments' assets to the entity's assets

This proposed amendment would remove an inconsistency in the disclosure requirements of IFRS 8. It would clarify that the reconciliation of the total of the reportable segments' assets in paragraph 28(c) of IFRS 8 should be disclosed only if that amount is regularly provided to the chief operating decision maker. This would align the requirements with those for segment liabilities in paragraph 28(d).

The IASB tentatively decided to include this in the next ED.

IAS 1 *Presentation of Financial Statements*: Current/non-current classification of debt

For this standard, the proposed amendment would clarify the meaning of 'unconditional right to defer settlement of the liability' in paragraph 69(d) of IAS 1.

It would amend the wording of paragraph 73 to clarify that for an existing loan that is due within 12 months of the reporting date to be classified as non-current, it must be refinanced with the same lender at the same or similar terms.

This would be applied prospectively from the beginning of the annual period in which it is first applied. It would not need to be applied to comparative information for periods before initial application.

The IASB tentatively decided to include the proposed amendment in the next ED, subject to the inclusion of additional explanations in the Basis for Conclusions.

IAS 7 *Statement of Cash Flows*: Classification of interest paid that is capitalised as part of the cost of an asset

These proposed amendments clarify the classification in the statement of cash flows of interest paid that is capitalised into the cost of property, plant and equipment.

The amendments would:

- explicitly include interest paid that is capitalised into the cost of property, plant and equipment in the example guidance in paragraph 16(a) of cash flows arising from investing activities; and
- clarify that interest paid that is capitalised in accordance with IAS 23 *Borrowing Costs* should be classified according to the classification of the underlying asset to which those payments were capitalised.

The IASB tentatively decided to include the proposed amendments, subject to some editorial amendments.

IAS 12 *Income Taxes*: Deferred tax assets related to unrealised losses on available-for-sale debt securities

These proposed amendments relate to future taxable profits and tax planning opportunities that would use deductible temporary differences and unused tax losses. They would clarify that:

- separate assessment should be made of each type of taxable profit if tax law specifically distinguishes a specific type of profit (e.g. capital gain) from other types of taxable profit;
- an action that results in the reversal of existing deductible temporary differences without creating or increasing taxable profit in the future is not a tax planning opportunity; and
- taxable profit against which realisation of a deferred tax asset is assessed is the amount before reversal of deductible temporary differences.

The IASB tentatively decided to include these amendments in the next ED.

IAS 16 *Property, Plant and Equipment*: Revaluation model and proportionate restatement of accumulated depreciation

The proposal here is to clarify guidance on the revaluation method to address concerns about calculating the accumulated depreciation at the date of the revaluation.

The IASB noted that the determination of the accumulated depreciation does not depend on the selection of the valuation technique used for revaluation. It also noted that the accumulated depreciation is computed as the difference between the gross and the net carrying amounts. Therefore, when the revalued amounts for the gross and net carrying amounts both reflect observable data, restatement of the accumulated depreciation is not proportionate to the change in the gross carrying amount of the asset.

The IASB tentatively decided to include these amendments.

IAS 24 *Related Party Disclosure*: Key management personnel

This proposed amendment clarifies the disclosure requirements for related party transactions that are identified when a management entity provides key management personnel services to a reporting entity and the management entity does not control, jointly control or have significant influence over the reporting entity.

Some IASB members raised concerns about potential unintended consequences of the proposed amendments, so the IASB asked the staff to consider these concerns and bring the proposals back to a future meeting.

IAS 36 *Impairment of Assets*: Disclosures for value in use and fair value less costs to sell

The aim with this proposal is to remove an inconsistency in the IAS 36 disclosure requirements for impairment losses. It would apply when entities recognise a material impairment loss or impairment reversal.

The change would include an explicit requirement in paragraph 130(f) of IAS 36 that when fair value less costs to sell is used to determine the recoverable amount, if the fair value less cost to sell is determined based on discounted cash flows, then an entity discloses the discount rate used in the calculation. This would align the disclosure requirements with those in paragraph 130(g) on value in use.

The IASB tentatively decided to include this in the next ED.

Issues not recommended for inclusion in this cycle

Following the IFRS Interpretations Committee's recommendation, the IASB agreed that the following issues do not meet the criteria for inclusion.

- IFRS 2: modification of a share-based payment from cash-settled to equity-settled.
- IAS 27 *Consolidated and Separate Financial Statements*: contributions to a jointly controlled entity or an associate.
- IAS 28 *Investments in Associates*: purchase in stages – fair value as deemed cost.
- IAS 28: equity method.

The IASB asked the IFRS Interpretations Committee to analyse further whether and where changes in the net assets of an associate, other than the investor's share of profit or loss distributions and other comprehensive income, should be recognised in the investor's financial statements. It asked the IFRS Interpretations Committee to recommend how the IASB might address this issue in the short term.

Financial assets and financial liabilities: Offsetting project

The IASB discussed:

- whether and how to address inconsistencies in the application of current offsetting requirements by adding application guidance to IAS 32 *Financial Instruments: Presentation*;
- whether consequential amendments to other IFRSs are necessary due to tentative decisions taken during this project;
- the effective date and transition for the IAS 32 application guidance and the converged disclosure requirements; and
- whether all mandatory and non-mandatory due process steps had been performed, and whether re-exposure is needed.

Based on its tentative decisions on the topics above, the IASB granted the staff permission to prepare amendments to IAS 32 and converged disclosure requirements for balloting.

IAS 32 application guidance

In its July 2011 meeting the IASB noted that the project consultation had highlighted inconsistencies in the application of IAS 32's offsetting requirements. In September 2011 it tentatively decided to address these inconsistencies by adding application guidance to IAS 32 to clarify the following.

- To satisfy the offsetting criterion in IAS 32.42(a), a right of set-off must be legally enforceable both in the normal course of business and in the event of default, bankruptcy or insolvency of one of the counterparties.
- For the purpose of evaluating the offsetting criterion in IAS 32.42(b), gross settlement systems would be considered equivalent to net settlement if they have features:
  - that eliminate or result in insignificant credit and liquidity risk; and
  - under which processing of financial assets and financial liabilities occurs in a single settlement process.

To identify whether gross settlement systems contain these features, the IASB identified distinguishing factors to consider.

Location of the guidance

The IASB tentatively decided that the offsetting criteria and amendments to the offsetting application guidance should remain in IAS 32. The disclosures should be placed in IFRS 7 *Financial Instruments: Disclosures*.

The amendments are due to be issued in December 2011.

Consequential amendments

The IASB tentatively decided that no consequential amendments to other IFRSs were necessary as a result of this project.

Effective date and transition

The IASB tentatively agreed that the amendments to the offsetting application guidance and the converged disclosure requirements should be applied retrospectively and be effective for annual and interim reporting periods beginning on or after 1 January 2013.

Due process and re-exposure

The IASB was satisfied that all mandatory due process steps for the offsetting project had been performed. It also felt that it had carried out enough non-mandatory due process steps.

The IASB tentatively decided that re-exposure is not needed for either the amendments to the IAS 32 application guidance or the converged disclosure requirements.

Financial instruments project: Hedge accounting

★ DYNAMIC HEDGING RELATIONSHIPS TO BE EXEMPT FROM CERTAIN DISCLOSURE REQUIREMENTS

The IASB concluded its redeliberations about the ED *Hedge Accounting*.

Disclosures: Dynamic strategies

A dynamic hedging strategy involves frequent resets (i.e. stopping and starting). The IASB tentatively decided that these hedging relationships would be exempt from the requirement to disclose the terms and conditions of the hedging instruments. Instead, entities would disclose:

- information about the ultimate risk management strategy;
- how they meet that objective by using hedge accounting and designating the particular hedging relationships;
- an indication of how frequently the hedging relationships are stopped and started; and
- that, for dynamic hedging processes, balances at the reporting date do not represent normal volumes during the year.

Transition

The IASB discussed feedback received on the transition to the new hedge accounting model. It made the following tentative decisions.

- Transition would be prospective, with limited exceptions (discussed below).
- Retrospective application to risk components, aggregated exposures and groups and net positions would therefore not be allowed.
- The mandatory effective date would be aligned with that for the other phases of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. If the proposals in the ED *Mandatory Effective Date of IFRS 9* are confirmed, it would be 1 January 2015.

Exceptions

Retrospective application of the accounting for the time value of options would be required for all hedging relationships in which the hedging instrument is designated under IAS 39 as the intrinsic value of an option. This applies to the types of hedging relationships that exist at the beginning of the comparative period.

The same retrospective application would be allowed for hedging relationships in which the hedging instrument is designated under IAS 39 as the spot element of a forward contract.

The accounting would not be available on a hedge-by-hedge basis – i.e. if an entity elects retrospective application, it would have to apply it to all hedging relationships of that type.

Practicalities

For transition purposes, entities would be able to consider the moment when IAS 39 stops applying and the moment from which the new hedge accounting model applies as the same point in time (the 'same logical second'). In other words, entities would be able to apply the new model immediately after they stop applying IAS 39.

The hedge ratio used under IAS 39 would be the starting point for rebalancing a hedging relationship on transition, which is needed to comply with the new requirements. Any gain or loss arising from the rebalancing would be recognised in profit or loss at the date of initial application of the new model.

Hedges of credit risk using credit derivatives

The IASB tentatively decided to use elective fair value through profit or loss accounting for credit exposures (such as loans, bonds and loan commitments). This would permit:

- election of fair value through profit or loss at initial recognition or subsequently;
- making that election for a component of nominal amounts; and
- discontinuation of fair value through profit or loss accounting.

This approach would align the accounting for loan commitments at discontinuation with that for loans.

The IASB also tentatively decided to require disclosure of:

- a reconciliation of the nominal amount and the fair value of the credit derivatives that have been used to manage the credit exposure of a financial instrument that qualified for and was elected for fair value through profit or loss accounting;
- the gain or loss recognised in profit or loss as a result of electing fair value through profit or loss accounting for a credit exposure; and
- for discontinuations of elective fair value through profit or loss accounting for credit exposures, the fair value that becomes the new deemed cost or amortisable amount (for loan commitments) and the related nominal or principal amount.

Next steps

The IASB asked the staff to draft the final requirements, including application guidance and a Basis for Conclusions. The proposed IFRS will not be formally re-exposed, but the draft will be available on the IASB website for about 90 days from November 2011 to allow for further outreach.

Macro hedge accounting

As a result of its outreach with banks and an education session in June 2011, the IASB discussed a common interest rate risk management concept. Its discussions included conceptual differences between this concept and the current hedge accounting requirements, and alternatives that address the differences. It did not make any decisions.

Financial instruments project: Impairment

Inconsistencies in application guidance in IAS 32 to be removed

The IASB and the FASB (the Boards) continued their discussions on a 'three-bucket' expected loss approach, which would make maximum use of credit risk management systems.

In discussing the feedback from recent outreach work, they focused on the operational challenges arising from the requirement to classify all financial instruments in Bucket 1 on initial recognition. These issues arise because credit risk management systems do not generally store historical data in a way that is easily accessible for accounting purposes. The Boards therefore tentatively decided that financial assets should be classified according to their credit quality levels on the reporting date.

This approach would lead to day one recognition of lifetime expected credit losses for those assets not classified in Bucket 1. The Boards asked the staff to look into how the model would accommodate the following:

- purchased financial assets, including those purchased under a business combination, that are required to be initially measured at fair value; and
- entities that primarily originate financial assets at lower credit quality levels.

The Boards also discussed transfers between buckets. They agreed that transfers should be based on a principal, not a bright line. They also agreed that the principal should reflect the point in time when the entity starts to manage the assets more actively because of heightened credit risk due to significant uncertainty about the ability to collect contractual cash flows.

Financial instruments project: Put options written over non-controlling interests

The IASB discussed a recommendation from the IFRS Interpretations Committee for a scope exclusion to IAS 32 for put options written over non-controlling interests in a group's consolidated financial statements. The objective would be to address a potential inconsistency between the requirements of IAS 32, IAS 39 and IFRS 9 *Financial Instruments* on measuring financial liabilities and the requirements of IAS 27 and IFRS 10 *Consolidated Financial Statements* on accounting for transactions with owners in their capacity as owners. The inconsistency is over whether the offsetting entry for subsequent measurement changes would be to profit or loss or to equity.

The IASB voted not to amend the scope of IAS 32 but did support consideration of the potential inconsistency. Rather than changing the measurement basis, it would prefer to clarify the accounting for subsequent changes in the measurement of such put options. It asked the staff to liaise further with the IFRS Interpretations Committee on how to progress this.

IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine*

The IASB approved this IFRIC interpretation subject to its final review of drafting changes.

The interpretation sets out the accounting for production stripping costs incurred in surface mining, including when and how to account for the two benefits arising from the stripping activity:

- usable ore that can be used to produce inventory; and
- improved access to further material that will be mined in the future.

The IASB agreed with the IFRS Interpretations Committee's conclusion that IFRIC 20 does not need re-exposing. It also approved a related amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

IFRIC 20 will apply for annual periods beginning on or after 1 January 2013. It will apply to costs incurred on or after the beginning of the earliest period presented, and includes guidance on transitional arrangements for pre-existing asset balances from stripping activity before that date.

The IASB expects to publish IFRIC 20 in mid-October 2011.

IFRS 1: Prospective application project

First-time adopters to have same prospective application provisions as existing preparers

The IASB had received a request to allow first-time adopters of IFRSs the prospective application provisions in certain IFRSs that are available to existing preparers of IFRS financial statements. Although some of the recent *Annual Improvements to IFRSs* have required or permitted prospective application for existing preparers, no equivalent amendments were made to IFRS 1.

The staff identified an amendment to IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* that they felt required amendment to IFRS 1. They recommended that IFRS 1 be amended to allow first-time adopters of IFRSs to apply paragraph 10A of IAS 20 prospectively.

The staff asked that the amendment be made separately – not as part of the *Annual Improvements to IFRSs* – so that it can be resolved quickly enough for entities adopting IFRSs in 2011 to benefit. The proposed amendment would take the form of an optional exemption, so that entities that have already made the transition in 2011 and produced quarterly reports would not have to amend their treatment when they prepare their annual financial statements.

The IASB tentatively accepted the staff recommendation and is likely to publish an ED in mid-October 2011.

IFRS 2 *Share-based Payment*

The IFRS Interpretations Committee recommended some of the issues it did not take onto its agenda to be considered by the IASB in a future agenda proposal for IFRS 2. The IASB agreed with the recommendation that the following be included:

- transactions in which the manner of settlement depends on future events; and
- vesting and non-vesting conditions, e.g. the classification of a non-compete agreement and the accounting for the interaction of multiple vesting conditions.

IFRS 8: Aggregation criteria and identifying the chief operating decision maker

The IASB received a request to amend:

- paragraph 22 of IFRS 8 to require disclosure of brief descriptions of:
  - the operating segments that have been aggregated; and
  - the economic indicators that have been assessed to conclude that the operating segments have 'similar economic characteristics' under paragraph 12 of IFRS 8;
- paragraph 7 of IFRS 8 to emphasise the 'operating nature' of the chief operating decision maker; and
- paragraph 1 of IFRS 8 to clarify that it is assumed that management reviews the information reported to it.

The IFRS Interpretations Committee recommended that the IASB consider these issues in a future post-implementation review of IFRS 8, rather than in an interpretation or annual improvement.

The IASB asked the staff to research how similar concerns have been addressed in US GAAP, noting the similarity to the equivalent guidance in Topic 280 *Segment Reporting* in the FASB Accounting Standards Codification. The staff is to consider how this may help identify ways to address the concerns about IFRS 8.

Insurance contracts project

No limit to available techniques for risk adjustment; confidence level equivalent disclosure retained

The Boards met on 19 September 2011 and discussed:

- disclosures;
- the objective and confidence level disclosure for the risk adjustment; and
- techniques and inputs for the risk adjustment.

In addition, the FASB held a separate meeting on 7 September 2011 to discuss the subsequent accounting for the single margin (i.e. composite margin) and the accounting for incurred claims in the post-claims period for contracts accounted for under the premium allocation approach.

The following were the main tentative decisions.

- The Boards would modify the disclosure requirements.
- The IASB would further refine the objective for the risk adjustment to be more consistent with IFRS 13 *Fair Value Measurement*.
- The IASB would not limit the range of available techniques for the risk adjustment.
- The IASB would retain the confidence level equivalent disclosure for the risk adjustment.
- The FASB would provide further guidance on the subsequent accounting for the single margin.
- Under a FASB decision, liability for incurred claims would be measured as the present value of unbiased expected cash flows excluding any margin under the premium allocation approach.

See our publication *IFRS – Insurance Newsletter* Issue 19 for more details.

Leases project

Fair value measurement of right to receive lease payments prohibited

The Boards discussed the practical application of the 'single' lessor accounting model.

Note the following key points.

- The Boards tentatively decided that the right to receive lease payments:
  - is not in the scope of financial instruments guidance for initial and subsequent measurement;
  - is in the scope of financial instruments guidance when assessing impairment; and
  - should be measured subsequently using the effective interest method.
- Lessor lease receivables would fall within the scope of financial instruments guidance for impairment.
- Residual value guarantees would not be recognised by lessors until payments are received.
- Lessor residual assets would be assessed for impairment in accordance with IAS 36.

The revised ED is due in Q1 of 2012.

See our publication *IFRS – Leases Newsletter* Issue 8 for more details.

Work plan

- The IASB ratified IFRIC 20 and expects to publish the new interpretation in mid-October 2011.
- The staff is to prepare a narrow-scope ED amending IFRS 1 to allow the prospective application of paragraph 10A of IAS 20 by first-time adopters of IFRSs. The ED is likely to be published in mid-October 2011.
- A review draft of the hedge accounting chapter of IFRS 9 should be available on the IASB website for 90 days from November 2011.
- The ED for the 2010/12 cycle of annual improvements is due to be published for comment in November 2011.
- Amendments to IAS 32 and IFRS 7 are also due to be issued in December 2011.
- The revised ED on revenue recognition is due to be released in Q4 of 2011 and that on leases in Q1 of 2012.

Abbreviations and icons

1 IASB: International Accounting Standards Board

2 FASB: US Financial Accounting Standards Board

Highlight for this topic

KPMG International Standards Group is part of KPMG IFRG Limited.

Publication name: *In the Headlines*

Publication number: Issue 2011/32

Publication date: October 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.