



On the Horizon for IFRS

March 23, 2010

IASB issues January 2010 joint meeting highlights

Financial crisis
Financial statement presentation
Leases
Revenue recognition

IASB issues January 2010 meeting highlights

Financial crisis
Amendments to IFRS 1
Discontinued operations
Financial statement presentation
Post-employment benefits

Future IASB meetings

IASB issues January 2010 joint meeting highlights

Key issues

At its January 2010 joint meeting the following issues were discussed:

- *Consolidation*: the Boards reached tentative decisions on control through voting rights and options and convertible instruments. No decisions were reached on agency relationships and kick-out rights.
- *Fair value measurement*: the Boards reached tentative decisions on the definition of fair value, measuring fair value when markets become less active, fair value at initial recognition, recognition of day one gains or losses, measuring liabilities at fair value, non-performance risk, restrictions on the transfer of a liability, measuring own equity instruments at fair value, market participant view, and reference market
- *Financial instruments* – classification and measurement: the Boards discussed the classification and measurement of financial liabilities. No decisions were reached.

- *Financial instruments* – hedge accounting: the Boards discussed possible timelines for the hedge accounting phase of the project and decided to address hedge accounting comprehensively
- *Financial instruments with characteristics of equity*: both Boards continue to struggle to find areas of agreement and decided not to adopt any of the approaches that they have previously considered. Instead, they directed the staff to analyze a new approach based on IAS 32, Financial Instruments: Presentation.
- *Financial statement presentation*: the Boards continued their deliberations on the proposals in the Discussion Paper, Preliminary Views on Financial Statement Presentation. The Boards reached tentative decisions on disaggregation of income and expense items by nature and function and segment disclosures. The Boards plan to issue an exposure draft on financial statement presentation in April 2010.
- *Insurance contracts*: the Boards reached tentative decisions on measurement and risk adjustments, day-one losses, treatment of residual margins, and policyholder behavior. The Boards plan to issue an exposure draft in May 2010.
- *Leases*: the Boards reached tentative decisions on subsequent measurement of leases, a concession for short-term leases, and investment properties held by lessors. Also, the FASB asked its staff to prepare an agenda request on whether to permit or require investment properties to be carried at fair value.
- *Revenue recognition*: the Boards reached tentative decisions on the disclosure requirements for the proposed revenue recognition model

All decisions reached at IASB meetings are tentative and may be changed or modified at future meetings. Board decisions become final only after completion of a formal ballot to issue a Standard or Interpretation or to publish an Exposure Draft.

The International Accounting Standards Board has issued an [IASB Update](#), which summarizes the joint IASB/FASB meeting that was held in London on January 18-20, 2010.

Highlights of the joint meeting are discussed below.

Financial crisis

The Boards discussed consolidation, fair value measurement, financial instruments: classification and measurement, financial instruments: hedge accounting, and financial instruments with characteristics of equity as part of their response to the global financial crisis. Additional information with respect to the global financial crisis issues is available on the IASB's [response to the financial crisis page](#).

Consolidation

The Boards discussed the following issues that relate to the control model that is being developed to determine whether one entity should consolidate another:

- Control through voting rights
- Options and convertible instruments
- Agency relationships, including kick-out rights

For purposes of this issue, the IASB agenda paper refers to the control definition in IASB Exposure Draft, *Consolidated Financial Statements*, and FASB Statement (SFAS) 167, *Amendments to Interpretation No. 46(R)*. According to the agenda papers, the Exposure Draft and SFAS 167 both define control as having two elements: (a) power and (b) rewards or benefits/losses. In the

agenda paper, the power element of the control definition refers to the power to direct the activities of an entity or, as in SFAS 167, the power to direct the activities that most significantly impact the entity's economic performance.

Control through voting rights

The Boards reached the following tentative decisions:

- In the absence of other arrangements, a reporting entity that holds more than half of the voting rights of an entity would meet the power element of the control definition
- A reporting entity with less than half of the voting rights in an entity would meet the power element of the control definition if the reporting entity has the legal or contractual ability to direct those activities of the entity that significantly affect returns

The IASB tentatively decided that a reporting entity with less than half of the voting rights in an entity without other contractual rights relating to the activities of the entity would meet the power element of the control definition if both of the following conditions exist:

- The reporting entity holds significantly more voting rights than any other party or organized group of shareholders
- The other shareholders are widely dispersed

This approach is referred to as the “dominant shareholder view” in the agenda paper.

The FASB tentatively decided that a reporting entity with less than half of the voting rights in an entity would meet the power element only if it can demonstrate that it has directed the activities of the entity that significantly affect returns.

Options and convertible instruments

The Boards considered whether a reporting entity that has potential voting rights meets the power element of the control definition.

The Boards tentatively decided that a reporting entity would consider potential voting rights through options and convertible instruments, whether currently exercisable or not, when assessing the power element. The reporting entity would consider not only the reporting entity's voting rights in another entity, but also an assessment of all of the facts and circumstances including the existence of options or convertible instruments.

Kick-out rights

The Boards discussed whether kick-out rights should be considered in the evaluation of power within the control definition. The staff presented two differing views on when kick-out rights may be considered substantive:

- View 1: Kick-out rights are considered only when exercisable by a single party
- View 2: Kick-out rights can be substantive if their exercise requires the agreement of more than one party

The Boards did not reach a tentative conclusion. A majority of the IASB supported View 2. They noted that kick-out rights may be substantive in certain situations based on facts and circumstances even when kick-out rights are held by more than one party. The FASB members supported View 1, consistent with the guidance in Statement 167.

Agency relationships

The Boards discussed the factors that should be considered to determine whether a party that has been delegated decision-making authority would be considered an agent. The Boards agreed with the staff that further analysis is necessary and asked the staff to further develop the views in light of the

tentative conclusion reached on the dominant shareholder view, consideration of options and convertible instruments, and kick-out rights.

See the [IASB project summary](#) for more information on this project.

Fair value measurement

In May 2009 the IASB issued an exposure draft on *Fair Value Measurement* (the Exposure Draft). At this meeting, the Boards discussed the following topics with respect to fair value measurement.

Definition of fair value

The Boards tentatively decided:

- To retain the term *fair value*. Some comment letters had expressed a preference for alternative terms, such as *current exit price* or *current value* (to emphasize its use of current conditions and information), *market value* (to emphasize its market-based nature), or *exchange value* (to emphasize that it represents an exchange transaction). The Boards did not agree with those comments.
- To define fair value as an exit price. The Boards will discuss where that definition would be used in a future meeting when they address the scope of a converged fair value measurement standard.

Measuring fair value when markets become less active

The Boards tentatively decided that the guidance for measuring fair value in markets that have become less active:

- Pertains to when there has been a significant decline in the volume and level of activity for the asset or liability. The Exposure Draft proposed that the guidance would also cover when the market for the asset or liability had always been inactive. Some believe that specific guidance for that circumstance is not necessary because previous levels of trading activity

are irrelevant. When there has not been an observable price in an active market in the past, presumably market participants have developed valuation techniques to measure fair value for those assets and liabilities.

- Focuses on whether an observed transaction price is orderly, not on the level of activity in a market. The Board asked the staff to redraft its proposed language about a bright line between an active and an inactive market to change the focus to the transaction, not the market in which it takes place. A transaction could still be orderly in a less active market. Conversely, a transaction could be disorderly in an active market, such as a forced or liquidation sale.

The Boards also tentatively decided that an entity would consider observable transaction prices unless there is evidence that the transaction is not orderly. Changes in market activity may be an indication that an observable price does not represent fair value. If an entity does not have sufficient information to determine whether a transaction is orderly, it would perform further analysis to measure fair value.

Fair value at initial recognition

The Boards considered whether the situations listed in FASB Topic ASC 820, *Fair Value Measurements and Disclosures*, and the exposure draft where transaction price might not represent the fair value of an asset or liability at initial recognition should be considered exhaustive. Despite the potential for opportunistic behavior, the Boards considered that other situations could exist. Therefore, the Boards agreed with the staff recommendation to use the language in ASC 820 and clarify that the list of situations where transaction price may not represent fair value provided in the guidance is not exhaustive. In addition, the Boards asked the staff to consider whether additional situations, such as government grants, should be added to the list in the converged guidance.

Recognition of day one gains or losses

The Boards discussed how to converge the guidance in IFRS with the guidance in ASC 820. IAS 39 prohibits the recognition of day one gains or losses for financial instruments unless there is observable evidence of the fair value. ASC 820 does not prohibit the recognition of day one gains and losses even when Level 3 inputs are used to determine fair value. The IASB tentatively decided not to address the recognition of day one gains or losses as part of the fair value measurement project. Conceptually, recognition or non-recognition of day one gains does not affect fair value measurement. Some believe it should be addressed in this project to promote consistency for all assets and liabilities. Others believe it should be addressed as part of the financial instruments project, but it has not yet been considered in the deliberations on IFRS 9, *Financial Instruments*. The Boards will discuss the recognition of day one gains or losses at a future meeting.

Measuring liabilities at fair value

The Boards discussed whether a reporting entity would need to incorporate a risk premium into the fair value measurement of a liability and whether such a premium was separate and distinct from the profit margin a market participant would demand for assuming a liability. The staff agreed to consider the element of risk introduced by factoring in the timing of the settlement into the discussion of risk premium when drafting the finalized guidance.

The Boards discussed the remaining issues in two parts. The first part addressed the value of a liability based on its transfer; the second part addressed the value of a liability based on its corresponding asset.

The value of a liability based on its transfer

Much controversy surrounds determining the fair value of liabilities based on their transfer price, because generally entities do not transfer liabilities. Entities generally fulfill liabilities and may be legally prohibited from transferring them. Liabilities are transferred in a business combination, but valuation is likely to be at an aggregate level with little or no practical benefit in determining value for individual liabilities.

Because observable transfers rarely take place, in general the transfer price is estimated in accordance with the objective that it reflects a market-based fulfillment amount. An entity could estimate the transfer price by determining either the present value of the resources a market participant would expect to expend to fulfill the obligation or the amount a market participant would receive to enter into an identical liability. In making that determination, the entity would consider:

- Direct and indirect costs incurred to fulfill the obligation
- Profit margin
- Time value of money
- Non performance risk
- Risk premium (uncertainty of cash flows)

For a non-financial liability, such as site remediation, an entity might be able to use objective information, such as the amount a third-party contractor would charge to undertake the activity to estimate the transfer price. This highlights that even if the entity intends to perform the work itself, the value being estimated is not based purely on cost, but must also include the foregone margin for undertaking the activity instead of other potential activities. The profit component will likely vary such that additional disclosure would be needed to provide insight into the estimated amount.

Accordingly, the Boards tentatively decided:

- To measure the fair value of a liability in the absence of a quoted price in an active market representing the transfer of a liability as follows:
 - Using the quoted price of the identical liability when traded as an asset in an active market (i.e. a Level 1 measurement), if that price is available
 - If that price is not available, using quoted prices for similar liabilities or similar liabilities when traded as assets (i.e. a Level 2 measurement)
 - If observable inputs are not available, using another valuation technique such as:
 - (1) An income approach (e.g. a present value technique) or
 - (2) A market approach (e.g. using the amount that a market participant would pay to transfer the identical liability or receive to enter into the identical liability)
- To describe the compensation a market participant would demand for taking on an obligation in the application of a present value technique
- To clarify that the transfer of a liability assumes that a market participant transferee has the knowledge and ability to fulfill the identical obligation

The value of a liability based on its corresponding asset

The Boards also discussed whether the fair value of a liability can be determined based on the fair value of the counterparty's corresponding asset. The Exposure Draft proposed that the entity use the same methodology that the counterparty would use to measure the corresponding asset. Current U.S. guidance allows the use of the value of the asset as a proxy when there is a quoted price for the asset.

There may be cases where the fair value of the liability does not equal the fair value of the corresponding asset. In that case, the fair value of the asset would be adjusted for the factors specific to the asset that are not applicable to the fair value of the liability. This requires judgment, together with an understanding of the characteristics of the liability and the asset and how they are different. For example, if the unit of account is different, such as when the quoted price for the asset includes a third party credit enhancement, the value of the asset would be adjusted. If the entity uses a quoted price for the corresponding asset without adjustment, that would be a Level 1 fair value measurement. If the entity must make adjustments to that quoted price, it would move to a lower level in the fair value hierarchy.

The U.S. guidance focuses on assets that have quoted prices. Intuitively, most liabilities are not traded as assets on an exchange. The IASB had proposed that in the absence of a quoted price the entity could use the methodology the counterparty would use to measure the fair value of the corresponding asset. However, that methodology could reflect assumptions that are different from those of a market participant. As fair value is market based, it would be preferable to use the methodology that a market participant would use.

Accordingly, the Boards tentatively decided:

- That an entity must determine whether the fair value of a liability when traded as an asset (the corresponding asset) represents the fair value of the liability. If an entity determines that the fair value of the corresponding asset does not represent the fair value of the liability, it must make adjustments to the fair value of the asset to the extent that its fair value does not represent the fair value of the liability.
- That the fair value of a corresponding asset represents the fair value of the liability whether or not that asset is traded on an exchange

- That the fair value of the corresponding asset would be measured using the methodology market participants would use
- That a quoted price for a corresponding asset in an active market is also a Level 1 fair value measurement for the liability when no adjustments to that quoted price are required

Non-performance risk

Non-performance risk refers to the risk that an obligation may not be fulfilled. For financial liabilities, it is equivalent to credit risk, i.e. the issuer's ability and willingness to pay. For non-financial liabilities, it relates to the risk that the entity will not be able to perform, such as the ability and willingness to perform and the ability to finance a decommissioning liability.

Some comment letters had objected to including non-performance risk in the fair value of a liability, because there is a counter-intuitive result when an entity's credit standing changes. An entity would recognize a gain when its credit standing deteriorates, and vice versa. Some suggest recognizing those gains and losses in other comprehensive income rather than profit or loss. Others have suggested a measurement that freezes the credit spread at initial recognition so that changes in credit standing and interest rates do not affect the subsequent value for the liability. However, the accounting in subsequent measurements is not considered within the scope of the fair value measurement project, which is limited to how to measure fair value, not when. The Boards tentatively decided:

- That the fair value of a liability includes the effect of non-performance risk
- To clarify what, in addition to credit risk, non-performance risk represents

Restrictions on the transfer of a liability

The Boards tentatively decided that the fair value of a liability would not be adjusted further for the effect of a restriction on its transfer if the restriction is

already included in the other inputs to the fair value measurement. Unlike for an asset, for which the fair value could be adjusted for a restriction affecting marketability, the fair value of a liability is a function of the requirement to fulfill the obligation. Because a market participant transferee would know of any restrictions on transfer, it would factor that into the price it would demand to assume the liability from the entity. A separate input or adjustment to other inputs would not be required.

Measuring own equity instruments at fair value

The Boards tentatively decided to include guidance for measuring the fair value of an entity's own equity instruments in a converged fair value measurement standard. The issue relates mainly to business combinations where the acquirer issues equity as consideration in the transaction. To some, the exit price objective does not seem applicable to an entity's own equity instruments because the entity can exit from that instrument only if the entity ceases to exist or if the entity repurchases the instrument from the holder. Equity is a residual interest in the entity, regardless of who holds the instrument. The most practical approach would be to measure the fair value of the equity instrument from the perspective of the market participant who holds it as an asset.

Market participant view

The Boards discussed the following three aspects of the market participant view:

- The level of knowledge market participants would be assumed to have regarding the asset or liability being measured
- The independence of market participants
- The extent to which a reporting entity's own data can be considered in Level 3 measurements.

The Boards tentatively decided:

- To confirm that a fair value measurement is market-based and reflects the assumptions that market participants would use in pricing the asset or liability. Some comment letters had suggested that an entity is more knowledgeable about cash flows of an asset or liability than a hypothetical market participant would be, and that an entity's own assumptions may be more reliable when markets are illiquid. However, an observed market price encompasses the consensus view of market participants about an asset or liability's utility, future cash flows, uncertainties, and premiums demanded to offset those uncertainties. The measurement objective is therefore market-based, not entity-based.
- That market participants would be assumed to have a reasonable understanding about the asset or liability and about the transaction, based on all available information, including information that might be obtained through due diligence efforts that are usual and customary, consistent with the guidance in ASC 820. The IASB had proposed in the Exposure Draft that the presumption be that market participants and the entity are equally knowledgeable. While that may have been practical, it ignored information asymmetry and the likelihood that the reporting entity would have access to information that is not available to other market participants.
- That *independence* in the description of market participants means that market participants are independent of each other; that is, they are not related parties (rather than independent of the reporting entity as specified in ASC 820). This language is intended to encompass situations where the reporting entity uses its own data as a starting point to estimate fair value (before adjusting for market participant assumptions), and situations where the reporting entity observes market transactions between other entities that may be related.

- That a price in a related party transaction may be used as an input to a fair value measurement if the transaction was entered into at market terms. A blanket prohibition against using information from related party transactions could cause practical difficulties in jurisdictions where many entities are state owned. Rather than ignoring observable transactions between related parties in all cases, an entity could instead determine whether the terms of the transaction are market based. In certain instances the price in a related party transaction may be representative of fair value but could not be described as an arm's-length transaction.
- That the unobservable inputs derived from an entity's own data must be adjusted for any reasonably available information that indicates market participants would use different data and for any entity specific considerations. The Boards tentatively decided to accept the language used in the IASB's exposure draft instead of the language in ASC 820 because it better describes the process for developing market-based assumptions when observable data is not readily available.

Reference market

- The Boards discussed whether the reference market for determining fair value should be determined using the principal market (or absent a principal market, the most advantageous market) approach in ASC 820 or the most advantageous market approach proposed in the Exposure Draft by the IASB. The Boards tentatively decided to converge to the approach in ASC 820. In addition, the Boards decided to clarify that the principal market is the market with the greatest volume and level of activity for the specific asset or liability. There had been some confusion in practice over whether level of activity should be determined by reference to the activity of the reporting entity or the activity of the asset

or liability. For example, an entity trades shares of a New York Stock Exchange-listed company exclusively in the principal-to-principal market. The principal market would be the NYSE because the greatest volume for the shares is there, not the principal-to-principal market where the entity has its greatest trading volume.

- There is a presumption that the principal market is the market in which the entity normally transacts. Entities do not need to perform an exhaustive search for markets that might have more activity than the market in which they normally transact. The Board believes that entities will know the markets where they could transact in most cases, but this presumption would preclude application issues around the sufficiency of the search for markets by the entity and its auditor.
- That the reporting entity must have “reasonable access” to the principal market. The determination of the most advantageous market would consider both transaction costs and transportation costs.

See the [IASB project summary](#) for more information on this project.

Financial instruments: classification and measurement

Financial liabilities

The objective of the financial instruments project is to improve the decision-usefulness of financial statements for users by simplifying the classification and measurement requirements for financial instruments. Although technically a joint project, the effort has been complicated by differing project timetables. The IASB has divided the project into three phases: classification and measurement (liabilities not included), impairment, and hedge accounting. The first phase resulted in the issuance of IFRS 9, *Financial Instruments*. The second phase resulted in an exposure draft on impairment. An IASB exposure draft is expected on hedge accounting in the first quarter of 2010. The FASB plans to

issue a comprehensive exposure draft in the first quarter of 2010. The Boards expect to complete the project before the end of 2010.

The Boards reviewed their respective prior discussions related to the classification and measurement of financial liabilities. In its exposure draft on classification and measurement of financial instruments, the IASB proposed a symmetrical classification approach for financial assets and financial liabilities. The IASB subsequently received almost unanimous feedback that symmetrical treatment of assets and liabilities is not necessary and unlikely to result in useful information about financial liabilities. The FASB at this point has tentatively decided to require a symmetrical classification approach for assets and liabilities.

Regarding subsequent measurement, the FASB has tentatively decided to measure liabilities at fair value, with a limited amortized cost option for particular liabilities. Changes in fair value would be recognized in net income or other comprehensive income, depending on characteristics of the liability. The IASB has tentatively decided to measure some financial liabilities at fair value and others at amortized cost. The IASB has also discussed other measurement methods to address the issue of own credit risk (e.g. the frozen credit spread method).

The Boards also discussed measurement issues in regards to the FASB proposal to recognize an intangible asset for core deposits.

At this meeting no decisions were made. The Boards plan to jointly deliberate this topic beginning in February 2010. Extra meetings have been planned.

See the [IASB project summary](#) for more information on this project.

Financial instruments: hedge accounting

The Boards have agreed to work together on the hedge accounting phase of the joint financial instruments project. At this joint meeting, the Boards discussed possible timelines for the hedge accounting phase, including the issues that might be addressed under each timeline. The staff presented two potential timelines. The first would comprehensively address the issues, but would continue into May 2010. The second would focus on hedge accounting issues that are more directly related to the financial instruments project due to decisions reached regarding the classification and measurement of financial instruments. This would leave current guidance unchanged for non-financial items, cash flow hedges, and measuring ineffectiveness. This timeline would be completed in March 2010.

The Boards tentatively decided to address hedge accounting comprehensively. However, in light of the FASB's goal to publish a comprehensive exposure draft on financial instruments in March 2010, and the IASB's goal to publish an exposure draft on the remaining main phases of the project to replace IAS 39 in the first quarter of 2010, the Boards will first jointly consider hedge accounting issues relating to financial hedged items, together with issues that are more directly related to the Boards' respective decisions to date on the classification and measurement models for financial instruments.

The Boards will subsequently discuss other hedge accounting issues, including hedge accounting for non-financial hedged items and portfolio hedge accounting. The Boards expect to address all hedge accounting issues in the first half of 2010.

See the [IASB project summary](#) for more information on this project.

Financial instruments with characteristics of equity

Both Boards continue to struggle to find areas of agreement in addressing issues surrounding these financial instruments. The Boards decided not to adopt any of the approaches that they have previously considered. Instead, they directed the staff to analyze a new approach based on IAS 32, *Financial Instruments: Presentation* with possible effects that may include:

- A requirement to classify as equity shares puttable only if specified certain events occur, such as the death or retirement of the holder
- A requirement to separate some puttable shares into equity and liability components
- A slight relaxation of the provision requiring exchanges of equity instruments for cash to be based on a fixed number of shares for a fixed amount of cash in order for the instrument to be classified as equity

See the [IASB project summary](#) for more information on this project.

Financial statement presentation

The Boards continued their deliberations on the proposals in the Discussion Paper, *Preliminary Views on Financial Statement Presentation*. Specifically, the Boards considered disaggregation of income and expense items by nature and function and segment disclosures.

The Discussion Paper proposed that within each category on the statement of comprehensive income, an entity would disaggregate its items of income and expense by function. Each of these functions would be further disaggregated by nature to the extent that such by-nature information enhances the usefulness of the statement of comprehensive income in predicting an entity's future cash flows. The Board affirmed the proposal in the Discussion Paper that permits an entity to present some or all of its by-nature information in the notes if presenting that information on the statement of comprehensive

income would result in a statement that is too lengthy or would detract from the overall understandability of the statement.

The Discussion Paper also proposed that if, in the opinion of management, presenting disaggregated information by function does not provide relevant information, an entity can disaggregate its items of comprehensive income by their nature within each category on the statement of comprehensive income.

The Boards plan to issue an exposure draft in April 2010.

Disaggregation by nature and function

At their January 2010 joint meeting, the Boards continued to discuss the tentative decisions reached in October 2009 specifically addressing two additional questions raised by Board members with respect to disaggregation by nature and function:

- Can an entity with only one reportable segment present some of its by-nature information in the notes to financial statements (as permitted in the Discussion Paper)? – The Boards tentatively decided that the exposure draft would specify that an entity with only one reportable segment may present its disaggregated by-nature information in a single note disclosure, rather than presenting that information on the statement of comprehensive income. The Boards agreed that by-function information would be repeated in the segment note to provide necessary context.
- What information will an entity with more than one reportable segment present on its statement of comprehensive income if the disaggregated nature and function information is presented in its segment note? – The Boards tentatively decided that an entity that disaggregates income and expense items by both function and nature in the notes to financial statements would present the statement of comprehensive income by function.

In addition the Boards reached a tentative decision to retain the Discussion Paper proposal that an entity would disaggregate its income and expense items in a manner that presents useful information for assessing the amount, timing, and certainty of future cash flows. Consequently, if disaggregation by function does not enhance the usefulness for that purpose of the information on the statement of comprehensive income, an entity would instead disaggregate its income and expense items by nature only.

Disaggregation by segment

The Boards discussed the following issues with respect to amendments to IFRS 8, *Operating Segments* and FASB ASC Topic 280, *Segment Reporting*:

- Similar composition and alignment of operating profit information on the statement of comprehensive income and in the segment note – The Boards reached a tentative decision that the exposure draft would require an entity that presents by-nature income and expense information in its segment note to classify items consistently between the statement of comprehensive income and the segment note
- Segregating all operating segment activities from corporate activities in the segment note – The Boards reached a tentative decision that the exposure draft would require an entity to present information about its operating segment activities that do not meet the criteria to be presented as a reportable segment separately from information about its corporate activities
- Reconciliation of reportable segments' operating profit or loss to the consolidated operating profit or loss – The Boards reached a tentative decision that the exposure draft would require an entity to reconcile the operating profit (loss) of its reportable segments to its consolidated operating profit (loss) presented on the statement of comprehensive income

See the [IASB project summary](#) for more information on this project.

Insurance contracts

The objective of the Insurance Contracts project is to provide a basis for consistent accounting for insurance contracts. The Boards discussed the following topics:

- Measurement and risk adjustments
- Day-one losses
- Treatment of residual margins
- Policyholder behavior
- Next steps

Measurement and risk adjustments

At their joint meeting in December 2009, the Boards tentatively decided that the measurement approach would portray a current assessment of the insurer's obligation, using the following building blocks:

- The unbiased, probability-weighted average of future cash flows expected to arise as the insurer fulfills the contract
- The time value of money
- A risk adjustment for the effects of uncertainty about the amount and timing of future cash flows
- An amount that eliminates any gain at inception of the contract

In this meeting, the Boards tentatively decided that:

- These building blocks would be used to measure the combination of rights and obligations arising from an insurance contract rather than to measure the rights separately from the obligations. That combination of rights and obligations would be presented on a net basis. There had been a question

as to whether the building blocks would measure just the obligation, with different measurement of the rights. The Boards believe that there is a strong interrelationship between the cash inflows (rights) and the cash outflows (obligations). They arise from the same contract, with each party obligated to perform by the other. The policyholder continues to make premium payments if the insurer keeps providing coverage, and vice versa.

- The objective for measuring an insurance contract would refer to a value rather than cost. The staff will refine the description of that objective. A characteristic of insurance contracts is a risk adjustment to cover uncertainty in the amount and timing of future cash flows. Measuring the cost to fulfill the present obligation would omit that amount, so a value notion is thought to be more appropriate.

The Boards also decided tentatively that:

- The risk adjustment would be the amount the insurer requires for bearing the uncertainty that arises from having to fulfill the net obligation arising from an insurance contract. The idea that this adjustment would be based on a market participant's view was rejected because the Boards agreed that the measurement of an insurance contract would reflect the fulfillment of that contract, which focuses on the insurer's perspective. The staff will develop guidance on how to determine the risk adjustment.
- The risk adjustment would be updated (remeasured) each reporting period. With the uncertainty surrounding future cash flows remeasurement is necessary for a faithful representation of both the measure of risk at the end of the period and the change in risk during the period.

Day-one losses

In the proposed accounting approach, a loss arises at inception if, after applying a risk adjustment, the expected present value of cash outflows exceeds the expected present value of cash inflows. The Boards tentatively decided that an entity would recognize that loss in profit or loss at inception. This is consistent with existing practice and with current discussions in other projects, such as regarding onerous contracts in revenue recognition.

Treatment of residual margins

The proposed accounting approach eliminates any gain at inception by including a residual margin in the measurement of the combination of rights and obligations arising from the insurance contracts. The Boards tentatively decided:

- To develop specific guidance on how the residual margin would be released to profit or loss over time. Although the Boards discussed different methods of releasing the residual margin without conclusion, they did agree that the forthcoming exposure draft would specify the method rather than allowing the entity to decide.
- That the insurer would not adjust the residual margin in subsequent reporting periods for changes in estimates. Locking in the margin at inception means subsequent changes in cash flows are reported in profit or loss as they occur, rather than being absorbed by any remaining residual margin.

Policyholder behavior

The Boards discussed features that enable policyholders to take actions that change the amount, timing, uncertainty, or nature of benefits that they will receive (policyholder options). For example, policyholders may have the option to cancel coverage, suspend premium payments, add coverage, withdraw cash, or take out a loan on the policy.

Valuing policyholder options can be difficult because there is no market for insurance renewal options or any formulaic approach (e.g. Black Scholes). The Boards discussed valuing the options by looking through to the expected future cash flows resulting from probability-weighted policyholder behavior. The Boards also discussed whether to include any cash flows other than in the existing insurance contract and whether to include a deposit floor, which refers to a requirement to value a financial liability at not less than the amount payable on demand, discounted from the first date it could be required to be paid.

The IASB reaffirmed its view that the policyholder options, as well as options, forwards, and guarantees related to existing coverage, would be included in the measurement of the insurance contract on a look through basis using the expected value of future cash flows (to the extent that those options are within the boundary of the existing contract). As a consequence, no deposit floor would apply. For a future discussion, the staff will develop material to identify the boundary of an existing contract.

The FASB discussed policyholder options. Views diverged and no clear consensus emerged. The FASB will return to the topic of policyholder behavior at a future meeting.

The Boards also discussed how to treat options, forwards, and guarantees that do not relate to the existing insurance contract coverage. The Boards tentatively decided to exclude such features from the measurement of that contract. Instead, those features would be recognized and measured as new insurance contracts or other stand-alone instruments, according to their nature.

Next steps

The Boards expect to continue their discussion of this project at an additional joint meeting on February 10, 2010, and plan to issue an exposure draft in May 2010.

See the [IASB project summary](#) for more information on this project.

Leases

The Boards discussed the following topics:

- Subsequent measurement of leases
- Concession for short-term leases
- Investment properties held by lessors

Subsequent measurement of leases

At prior joint meetings, the Boards tentatively decided on the following issues:

- The initial measurement of the lessee's obligation to pay rentals and the lessor's receivable would be at the present value of lease payments using the lessee's and the lessor's discount rate. The lessor's receivable would also include initial direct costs incurred by the lessor.
- The subsequent measurement of the lessee obligation and the lessor receivable would be at amortized cost using the effective interest method
- The expected lease term would be the longest possible lease term that is more likely than not to occur
- The lessee's obligation to pay rentals and the receivable recognized by the lessor would include amounts payable under contingent rental arrangements
- The expected lease term and the amount of contingent rentals would be reassessed at each reporting date

In light of these tentative decisions, the Boards addressed how to apply the amortized cost method when there are reassessments of the expected lease terms and contingent rentals.

The Boards tentatively concluded that neither the lessee's nor the lessor's discount rate would change when there are subsequent changes in the expected lease term. The Boards also tentatively decided that the discount rate used by the lessee and the discount rate used by the lessor would not be revised when there are subsequent changes in contingent rentals unless the rentals are contingent on various reference interest rates.

Concession for short-term leases

The Boards continued their discussion on whether to provide a scope exclusion for short-term leases for lessees and lessors and reached the following tentative decisions.

Lessee

In the IASB agenda paper, the staff pointed out that a materiality threshold is applied to all accounting requirements. Therefore, the issue addresses whether an additional exclusion beyond the materiality principle would apply to the proposed new lease requirements.

The Boards tentatively decided that lessees would not be allowed to exclude short-term leases from the proposed new requirements. Rather, the Boards tentatively decided that lessees would be allowed to use a simplified form of lease accounting for short-term leases. Under this accounting, the lessee would recognize the gross amount payable and a corresponding right-of-use asset. The Boards also tentatively decided that a short-term lease would be defined as a lease that has a maximum term of less than twelve months. The maximum term would include options to renew or extend a lease.

Lessor

The Boards tentatively decided to provide lessors with an optional concession for short-term leases.

Investment properties held by lessors

The Boards discussed how a lessor should account for leases of investment properties. Under IAS 40, *Investment Properties*, an investment property is defined as a property that is held to earn rentals or for capital appreciation or both. IAS 40 gives an entity a choice to measure investment properties, after recognition, using either the fair value model or the cost model with some exceptions.

The Boards tentatively decided that if a lessor measures its investment properties at cost, the new lease requirements would be required. However, if the lessor measures its investment property at the fair value concepts in IAS 40, the Boards tentatively decided that it would not apply the new lease requirements to the lease.

Currently, U.S. GAAP does not include an option to fair value investment property. Therefore, the FASB asked its staff to prepare an agenda request on whether to permit or require investment properties to be carried at fair value.

See the [IASB project summary](#) for more information on this project.

Revenue recognition

The Boards considered the disclosure requirements for the proposed revenue recognition model and tentatively decided:

- To specify a high-level disclosure objective similar to the objectives in FASB ASC Section 605-25, *Multiple Element Arrangements* and IFRS 7, *Financial Instruments: Disclosures*. Specifying a disclosure objective is useful as a framework from which to develop specific disclosures. It also assists preparers and auditors as a guideline for assessing the overall quality and

informational value of disclosure. The U.S. guidance requires both qualitative and quantitative disclosure and disclosures about the effect of judgment on the amount and timing of revenue recognized. The IFRS guidance also requires disclosure of risks.

- To require an entity to disclose:
 - The nature of contracts that it enters into with customers and the related accounting policies
 - The principal judgments used in accounting for contracts with customers
 - A reconciliation of the beginning and ending net contract position(s)
 - The total amount of outstanding performance obligations and the expected timing of their satisfaction
 - Information about onerous contracts, including the extent and amount of such contracts and the reasons for them becoming onerous

The staff will continue to develop proposals for revenue disclosures. The Boards will continue their discussion of disclosures and consider scope and transition issues at the forthcoming meetings.

See the [IASB project summary](#) for more information on this project.

IASB issues January 2010 meeting highlights

Key issues

At its January 2010 IASB meeting the following issues were discussed:

- *Derecognition*: the IASB discussed the requirements in IAS 32, Financial Instruments: Presentation for offsetting a financial asset and a financial liability, as well as the differences between the IFRS and U.S. GAAP requirements. No decisions were reached.
- *Financial instruments – hedge accounting*: the IASB discussed two possible objectives for hedge accounting in the context of whether risk components could qualify for hedge accounting under any approach the IASB may propose. No decisions were reached.
- *Amendments to IFRS 1*: the IASB decided that first-time adopters would be permitted to use the same transition provisions permitted for *Improving Disclosures about Financial Instruments (amendments to IFRS 7)*, issued in March 2009, for existing preparers of financial statements prepared in accordance with IFRS. Subsequent to its January 2010 meeting, the IASB issued *Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters (Amendment to IFRS 1)*.
- *Discontinued operations*: the IASB decided that the comment period for the exposure draft to re-expose proposals to amend IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* would be 60 days
- *Financial statement presentation*: the IASB reached a decision not to make any additional amendments to IFRS 8, *Operating Segments*, beyond those which they had tentatively agreed at the January 2010 joint meeting. In addition the IASB reached a tentative decision on net debt information

and discussed financial services entities. The IASB asked the staff to obtain cost/benefit information on the changes proposed for preparing a direct method cash flow statement.

- *Post-employment benefits*: the IASB expects to issue the exposure draft on post-employment benefits for recognition, disclosures, and other issues early in 2010 and a final standard in the first half of 2011. In addition, the IASB expects to issue the final amendments for post-employment termination benefits in the first quarter of 2010. These amendments will increase convergence with U.S. GAAP, although some differences for the accounting for termination benefits will remain.

All decisions reached at IASB meetings are tentative and may be changed or modified at future meetings. Board decisions become final only after completion of a formal ballot to issue a Standard or Interpretation or to publish an Exposure Draft.

The International Accounting Standards Board has issued an [IASB Update](#), which summarizes the IASB meeting that was held on January 21, 2010.

Highlights of the IASB meeting are discussed below.

Financial crisis

The IASB discussed derecognition and financial instruments: hedge accounting as part of its response to the global financial crisis. Additional information with respect to the global financial crisis issues is available on the IASB's [response to the financial crisis page](#).

Derecognition

Offsetting is the presentation of financial assets and financial liabilities on a net basis in the primary financial statements. Offsetting is a presentation issue rather than a derecognition issue. However, some respondents to the IASB's

exposure draft on derecognition requested that the IASB revisit the guidance on offsetting as part of the derecognition project. At this meeting, the IASB discussed the requirements in IAS 32, *Financial Instruments: Presentation* for offsetting a financial asset and a financial liability, as well as the differences between the IFRS and U.S. GAAP requirements.

The guidance on offsetting in IFRS and U.S. GAAP is broadly similar, requiring a legal right of set off and an intention to do so. Under IFRS, when the offset criteria are met, an entity is *required* to offset; under U.S. GAAP the entity is *permitted* to offset. Conceptually, IFRS focuses on circumstances that arise both in the normal course of business and in default or termination; U.S. GAAP focuses on the expected outcome in the event of default. IFRS prohibits offset when the right of offset is conditional or enforceable only on the occurrence of some future event. U.S. GAAP, in some circumstances, permits offset when the ability to offset is conditional and there is lack of intent to offset or such intent is conditional, such as a master netting arrangement.

Other issues may complicate resolution of the offsetting debate. Intention to offset is difficult to know or verify. The laws of different legal jurisdictions may impact whether there is a legal right of offset, and the right to set off may arise from the law or from contract. In some cases netting of collateral may be justified.

The IASB did not make any decisions at this meeting. The IASB will continue discussions on the issue at future meetings.

See the [IASB project summary](#) for more information on this project.

Financial instruments: hedge accounting

The IASB previously established its intention to develop a principle-based approach to hedge accounting. At this meeting, the Board focused on

determining an objective for hedge accounting. Two possible objectives were discussed:

- To provide a link between an entity's risk management and its financial reporting
- To mitigate the recognition and measurement anomalies between the accounting for hedging instruments and hedged items, and to manage the timing of the recognition of gains or losses on hedging instruments used to mitigate cash flow risk

The first objective would focus on the purpose of the entity's risk management. By providing information about the purpose and effect of hedging instruments used in managing the entity's exposures, this objective would reflect how risk management activities affect performance and financial position. Underpinning the objective would be principles on the measurement of ineffectiveness and its recognition in profit or loss.

The second objective would focus on reflecting in the financial statements the economics of risk management activities. Mitigation of recognition and measurement anomalies by reflecting the economics of individual assets and liabilities being hedged would better enable an entity to determine the effectiveness of the hedging relationship.

The IASB discussed the possible objectives in the context of whether risk components could qualify for hedge accounting under any approach that the IASB might propose. For a variety of reasons, many hedging strategies involve hedging of components. These "partial hedges" raise the issue of whether the effectiveness of the hedging relationship should be based on all the hedged item's risks or only on those risks that management has "bifurcated" from the total risk exposure. Currently, bifurcation of risk is allowed although significantly limited for non-financial items. If risk

components can be designated as hedged items, a question arises as to how to ensure that the risk components identified actually represent the components that are hedged so that ineffectiveness is properly recognized in profit or loss.

The IASB noted that a hedge accounting objective should permit or require hedge accounting for risk components if a risk component is separately identifiable and measurable for the purpose of determining hedge ineffectiveness. The IASB also noted that a hedge accounting objective and the treatment of risk components should apply to both financial and non-financial hedged items.

No decisions were made.

See the [IASB project summary](#) for more information on this project.

Amendments to IFRS 1

The IASB considered the comments received on the Exposure Draft, *Limited Exemptions from Comparative IFRS 7 Disclosures for First-time Adopters* (proposed amendment to IFRS 1), which was issued in November 2009. To avoid the potential use of hindsight and to ensure that first-time adopters are not disadvantaged as compared with current IFRS preparers, the IASB decided that first-time adopters would be permitted to use the same transition provisions permitted for *Improving Disclosures about Financial Instruments (Amendments to IFRS 7)*, issued in March 2009, for existing preparers of financial statements prepared in accordance with IFRS. The transition provisions in paragraph 44G of IFRS 7 provide relief from providing comparative information for the disclosures required by the amendments in the first year of application. Currently a first time-adopter under IFRS 1, *First-time Adoption of International Financial Reporting Standards*, would not receive the same relief.

In addition, the IASB also decided to amend paragraph 44G of IFRS 7 to clarify which comparative periods are exempted by the transition provisions. The IASB decided to clarify that an entity would not have to provide comparative information for the disclosures required by the amendments for (a) any periods presented ending before January 1, 2009 and (b) any statement of financial position as of a date before December 31, 2009.

Note: On January 28, 2010, the IASB issued *Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters (Amendment to IFRS 1)*.

See the [IASB project summary](#) for more information on this project.

Discontinued operations

The IASB decided that the comment period for the exposure draft to re-expose proposals to amend IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* would be 60 days.

The IASB is working with the FASB to develop a common definition of discontinued operations and to require common disclosures related to disposals of components of an entity.

See the [IASB project summary](#) for more information on this project.

Financial statement presentation

The IASB discussed the following issues with respect to the proposals in the Discussion Paper, *Preliminary Views on Financial Statement Presentation*, which was issued in October 2008.

Segment disclosures

The IASB continued its discussion from the February 19, 2010 joint meeting on possible amendments to IFRS 8, *Operating Segments* to accommodate the core presentation principles of cohesiveness and disaggregation. The IASB

reached a decision not to make any additional amendments to IFRS 8 beyond those which they had tentatively agreed at the joint meeting (see joint meeting above).

Financial services entities

The IASB considered whether, and if so to what extent, the exposure draft on financial statement presentation would be applied by financial services entities. The IASB agreed that many of its tentative decisions to change proposals in the Discussion Paper address the concerns expressed by financial services entities. The only tentative decision that the IASB specifically discussed that related to a financial services entity is the requirement to present a direct method statement of cash flows. The IASB discussed different ways in which a financial services entity might present cash flow information in the financial statements. The IASB asked the staff to do more research on this issue for discussion at a future meeting.

Costs and benefits

The IASB reviewed a summary of the information received regarding the overall costs of the proposed financial statement presentation model. In prior meetings, the IASB and the FASB have discussed both the costs and benefits of individual aspects of the proposed presentation model. The Boards have reached a number of tentative decisions that are expected to reduce the costs of implementing the proposed model but retain its benefits. The IASB asked the staff to obtain cost/benefit information on the changes proposed for preparing a direct method cash flow statement.

Net debt information

At its September 2009 meeting, the IASB tentatively agreed to require information about net debt to be presented in the financial statements and

expressed a preference for presenting an analysis of net debt in the notes to the financial statements. The FASB decided in September 2009 not to support requiring disclosure of net debt information.

At its January 2010 meeting, the IASB reached a tentative decision to require the analysis of changes in specific line items (all the line items in the debt category, cash, any short-term investments, and finance leases) to be included in a single note disclosure. These line items typically constitute what users of financial statements sometimes refer to as net debt. *Net debt* are the financial liabilities that an entity classifies in the financing section together with the resources available to service those financial liabilities.

See the [IASB project summary](#) for more information on this project.

Post-employment benefits

The IASB discussed disclosures and termination benefits.

Disclosures

In March 2008, the IASB issued a Discussion Paper, *Preliminary Views on Amendments to IAS 19 Employee Benefits*. The comment period ended on September 26, 2008. The Discussion Paper sets out the IASB's preliminary views on how the accounting for some post-employment benefits, including pensions, could be improved. The Board has completed its decisions on all the issues to be covered by the exposure draft except proposed disclosures (included in the January 2010 Agenda Paper 12A). The Board asked the staff to reduce and streamline the disclosures. The Board will consider the revised set of disclosures at a future meeting.

The Board expects to issue the exposure draft on recognition, disclosures and other issues early in 2010 and a final standard in the first half of 2011.

Termination benefits

In June 2005, the Board issued an Exposure Draft of Amendments to IAS 19, dealing with the accounting for termination benefits, together with proposed amendments to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. In October 2009, the Board tentatively decided that entities would apply the amendments for annual periods beginning on or after January 1, 2011 with early adoption permitted. During the drafting of the pre-ballot draft of amendments, the staff identified two issues that it would like the Board to ratify in a public meeting. At its January 2010 meeting, the IASB discussed these issues and tentatively decided that:

- The definition of termination benefits would include only benefits provided in exchange for termination of employment and not include benefits provided in exchange for future employee service. Benefits that an entity provides in exchange for employees' future services, such as when an entity provides higher benefits if employees stay for a period before termination (a stay bonus), would be regarded as post-employment benefits, not termination benefits.
- An entity would recognize termination benefits when it no longer has the ability to withdraw an offer of those benefits, not over a future period of service

The IASB expects to issue the final amendments for termination benefits in the first quarter of 2010. These amendments will increase convergence with U.S. GAAP, although some differences for the accounting for termination benefits will remain.

See the [IASB project summary](#) for more information on this project.

Future IASB meetings

The IASB held subsequent meetings (some of them jointly with the FASB) on February 2, 10, and 15-19, 2010; March 3, 11, and 15-24, 2010. The next IASB meetings (some of them jointly with the FASB) are scheduled for April 8 and 19-23, 2010.

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