



On the Horizon for IFRS

March 25, 2009

IASB issues February 2009 meeting highlights

IASB responds to the global financial crisis
IASB continues discussions of proposed IFRS for non-publicly accountable entities
Interim financial reporting discussed
Board discusses insurance contracts
IASB discusses post-employment benefits
Rate-regulated activities discussed
Annual improvements
Future Board meetings

IASB enhances financial instruments disclosures

Fair value measurement disclosures
Liquidity risk disclosures
Effective date

IASB issues request for views on proposed FASB guidance regarding fair value measurement and impairments of financial instruments

IASB and FASB issue joint discussion paper on lease accounting

IASB issues February 2009 meeting highlights

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 the February 2009 [IASB Update](#) which summarizes the Board meeting in London on February 17-20, 2009. Highlights of the meeting are discussed below.

IASB responds to the global financial crisis

The IASB discussed derecognition, fair value measurement, and embedded derivatives as part of its response to the global financial crisis. Additional information with respect to global financial crisis issues is available on the [IASB's financial crisis page](#).

Derecognition

The Board decided that for purposes of defining the scope of the project, that the definition of *transfers* would be broadly defined so that the decision to assess an item for derecognition would not be based on the form of the

transaction. A *transfer* would occur “when one party passes to or undertakes to pass to another party some or all of the cash flows or other economic benefits underlying its financial assets.” The term *transfer* includes all forms of sale, assignment, and provision of collateral, sacrifice, distribution and other exchange.

The Board continued its discussion of Approach 2 to derecognition of financial assets and reached the following conclusions:

- The reporting entity level of the transferor would be the level at which to determine the asset to be assessed for derecognition and to perform the assessment of continuing involvement.
- The determination of the asset to be assessed for derecognition would be based upon the remaining interest in the financial asset that was the subject of the transfer. A proportionate part of an equity instrument qualifies as an asset to be assessed for derecognition. This is a change from the decision the Board made at the January 2009 meeting.
- The *practical ability to transfer* test would be applied to the entity with which the transferor has agreements that result in the transferor’s continuing involvement with the transferred asset.
- The Board reaffirmed that a transferor would treat any retained interest (any remaining proportionate interest in the financial asset recognized before the transfer) as part of the original asset (i.e. not as a new asset).
- The Board reached a tentative decision that a transferor would account for proportionate beneficial interests acquired in connection with a transfer (an investment in the transferee vehicle) as part of the previously recognized asset. If the vehicle contains assets or liabilities in addition to the assets transferred by the transferor, the transferor would allocate the investment

between (a) a proportionate interest in the previously recognized assets and (b) a proportionate interest in the newly acquired assets or liabilities. This decision is a change from the tentative decision the Board reached at its meeting in January 2009.

The Board reached a tentative decision that the disclosure objectives for Approach 2 should provide the following information:

- *Disclosure objective 1:* The nature of, and risks associated with, an entity’s continuing involvement with derecognized assets
- *Disclosure objective 2:* The relationship between assets and associated liabilities when an asset is not derecognized following a transaction

The Board also reached a tentative decision on the following transition provisions:

- The standard would be applied prospectively to new transactions occurring after its effective date. An entity would not restate information for comparative periods. Earlier application would be permitted.
- An entity would apply disclosure objective (1) for financial assets that were already derecognized but would not have been derecognized under the proposed requirements
- An entity would apply disclosure objective (2) for financial assets that are still recognized but would have been derecognized under the proposed requirements

The Board reached a tentative decision to propose Approach 2 in the Exposure Draft and include a detailed description of Approach 1 as an alternative view. The Board plans to publish the Exposure Draft in March or April 2009, with a comment period of 120 days.

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

Fair value measurement

Fair value of liabilities

The Board discussed how to measure the fair value of a liability when there is no observable market price for the liability. The Board reached a tentative decision that the fair value of a liability equals the fair value of the counterparty's asset in all cases. However, some have suggested that the fair value of the liability might differ from the fair value of the counterparty's asset in certain cases, for example when the counterparty's asset is accompanied by a third party credit enhancement. The Board concluded that any apparent differences between the fair values of the liability and the counterparty's asset arise from differences between the way the counterparty's asset and the liability are defined.

Day one gains or losses

The Board discussed gains and losses arising upon initial recognition of financial instruments, which are referred to as day one gains or losses. The Board reaffirmed its tentative decision that the transaction price is the best evidence of fair value at initial recognition except in the cases of related parties, duress, different units of account, or different markets. If the transaction price does not represent the fair value of a financial instrument at initial recognition, an entity would recognize the resulting day one gain or loss as required by the existing criteria in IAS 39, *Financial Instruments: Recognition and Measurement*. Any deferred gain or loss is recognized as a separate item, not as part of the fair value of the financial instrument.

The Board had reached a tentative decision in January 2009 that day one gains or losses would not be recognized for financial instruments measured on a basis

other than fair value through profit or loss. To avoid changes to IAS 39 that are beyond the scope of this project, the Board withdrew that decision.

Financial liabilities with a demand feature

The Board reached a tentative decision to exclude financial liabilities with a demand feature (paragraph 49 of IAS 39) from the scope of the exposure draft on fair value measurement.

Next steps

The discussions on fair value measurement are now complete except for any matters that may arise in drafting. The Board plans to issue an exposure draft at the beginning of the second quarter of 2009.

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

Financial instruments: embedded derivatives

In December 2008 the Board issued the Exposure Draft, *Embedded Derivatives*, which proposes amendments to IAS 39 and to IFRIC 9, *Reassessment of Embedded Derivatives*. At its meeting in February 2009, the Board reached the following tentative decisions:

- An entity would be required to assess whether an embedded derivative must be separated from a host contract whenever the entity reclassifies a hybrid (combined) financial asset out of the fair value through profit or loss category. The assessment would be made on the basis of the circumstances that existed when the entity first became a party to the contract or, if later, the date of a change in contractual terms with a significant effect on cash flows.
- If an entity cannot make an assessment, then the entire hybrid (combined) financial asset must remain in fair value through profit or loss.

- If the assessment indicates that the embedded derivative must be separated and the entity is unable to measure the amount attributable to the derivative, then the entire hybrid (combined) financial instrument must remain in the fair value through profit or loss category.
- The final amendments would be effective for annual periods ending on or after June 30, 2009.

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

Note: On March 12, 2009, the IASB [announced](#) the issuance of *Embedded Derivatives (Amendments to IFRIC 9 and IAS 39)* (the Amendments), which are conforming amendments for changes made to IAS 39, *Financial Instruments: Recognition and Measurement*, in October and November 2008 that permitted the reclassification of non-derivative financial assets out of the fair value through profit or loss category in certain circumstances. The Amendments are effective for annual periods ending on or after June 30, 2009. Since there are no stated transition provisions, retrospective application will be required in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Example

An entity holds an investment in a convertible bond. It acquired the investment on July 1, 2008 and classified it as held for trading (at fair value through profit or loss). Accordingly, the embedded conversion option was not assessed for separation at the date of initial recognition (see IAS 39.11(c)). On December 31, 2008, the entity determines that it meets the conditions in IAS 39.50(c) and 50D to reclassify the investment out of the held for trading category and into the loans and receivables

category.

Before reclassifying the investment, the entity assesses whether the embedded conversion option is required to be separated and accounted for as a derivative. It makes the assessment based on the circumstances at July 1, 2008 (the date of initial recognition). Based on IAS 39.AG30(f), the entity determines that separation is required.

The separation and reclassification are then effected using values current at the date of reclassification (not the initial recognition date). Therefore, if on December 31, 2008 Company A determines that the fair value of the convertible bond is CU850 in total, and that this comprises CU800 for the host debt asset (an equivalent bond without the conversion option) and CU50 for the conversion option, it:

- Reclassifies the host debt asset into loans and receivables at its fair value of CU800 based on IAS 39.50C
- Recognizes a derivative financial asset of CU50 which is subsequently measured at fair value through profit or loss.

Financial instruments: synthetic collateralized debt obligations

The staff provided an update to the Board on the accounting for synthetic collateralized debt obligations (CDOs) and credit derivatives that are embedded in such instruments.

See the [financial crisis section](#) of the IASB website for more information on this topic.

IASB continues discussions of proposed IFRS for non-publicly accountable entities

The IASB discussed simplification of defined benefit pension accounting, which is the only remaining issue in its project to develop an IFRS for non-publicly accountable entities (formerly private entities or small and medium-sized entities). In the exposure draft of a proposed IFRS for SMEs the requirements proposed for defined benefit plans were similar to, but condensed from, those in IAS 19, *Employee Benefits*.

The Board had previously asked the staff to bring to a future meeting an approach to measure the pension obligation that is more in line with the current IAS 19 approach, but with simplified calculations that would reduce the need for non-publicly accountable entities (NPAEs) to engage external specialists. At the February 2009 IASB meeting, the staff presented a revised approach, based on input from the IASB's Employee Benefits Working Group.

The Board reached the following tentative decisions:

- If the information required to perform the measurement in IAS 19 paragraph 50 (projected unit credit etc.) is already available or can be obtained without undue cost or effort, an NPAE would use that method. Comprehensive valuations would not normally be necessary more than once every three years. The valuations would be rolled forward with aggregate adjustments for employee composition and salaries in the intervening years, but without adjustments for changes in the turnover or mortality assumptions.

- If information required by IAS 19 is not available and cannot be obtained without undue cost or effort, an NPAE would apply an approach that is similar to that in IAS 19 but does not consider future salary progression, future service, or possible mortality during an employee's period of service. The NPAE would still take into account the life expectancy of its employees after retirement age. The defined benefit pension obligation would include both vested and unvested benefits.

- Further guidance would be added on insured benefits

The Board has reached tentative decisions on all of the NPAE substantive issues, so at its meeting in March 2009, the Board will consider whether re-exposure is necessary before a final standard is issued.

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

Interim financial reporting discussed

The Board discussed whether some additional disclosure requirements should be mandated in interim financial reports, particularly in current market conditions. The Board reached a tentative decision to emphasize the disclosure principles in IAS 34, *Interim Financial Reporting*, and to consider adding further guidance to illustrate how to apply these principles.

Board discusses insurance contracts

The Board discussed key aspects of the approaches identified by the staff as viable candidates for measurement of insurance contracts.

Features of a measurement approach

The Board reached a tentative decision that a measurement approach for insurance contracts conceptually would:

- Use estimates of financial market variables that are as consistent as possible with observable market prices
- Use explicit current estimates of the expected cash flows
- Reflect the time value of money
- Include an explicit margin

Measurement objective

The Board discussed whether a measurement approach for insurance contracts should be based on an exit price notion or a fulfillment notion. No decisions were reached.

Measurement of the margin at inception

The Board reached a tentative decision that the margin at inception would be measured by reference to the premium. No day one gains would be recognized in profit or loss. The Board will discuss the accounting for acquisition costs and the part of the premium that recovers those costs at a future meeting.

Consideration of measurement approaches

The staff presented measurement approaches for consideration by the Board. The Board asked the staff to analyze further whether to apply measurement approaches used in other existing and future standards, notably those on revenue recognition, financial instruments, and non-financial liabilities.

The Board noted the arguments both for and against an approach that uses an estimate of future cash flows without consideration of margins and without discounting. The Board discussed whether to use this approach for non-life insurance claim liabilities and reached a tentative decision not to add it to the list of candidates. Other measurement approaches to be considered at future meetings include an unearned premium approach for short-duration pre-claim liabilities (the stand-ready obligation to pay valid claims for future insured

events arising under existing contracts). The unearned premium approach measures pre-claims liabilities by reference to the unexpired portion of the consideration received.

Next steps

At its March 2009 meeting, the Board will discuss policyholder behavior and participation. See the [IASB project summary](#) for more information on this project.

IASB discusses post-employment benefits

The Board considered how to segregate the changes in the defined benefit obligation and in plan assets into a remeasurement component and other changes. The IASB reached a tentative decision that the remeasurement component would:

- Exclude service cost and interest cost
- Include the total actual return on plan assets
- Include actuarial gains and losses on the defined benefit obligation

The IASB did not reach a decision on how entities should present either those components or the remeasurement component in the income statement. The IASB will continue its discussions at its March 2009 meeting.

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

Rate-regulated activities discussed

The Board reached a tentative decision that two criteria would define rate-regulated activities:

- An authorized body is empowered to establish rates that are binding on customers

- The rate regulation takes the form of a cost-of-service regulation. In such regulation, the rates are designed to recover the regulated entity's costs of providing the goods and services that are subject to regulation and to earn a specified return. The specified return could be determined as a minimum or range of returns and need not be fixed in amount or guaranteed.

The Board generally agreed with the analysis supporting the staff's conclusion that cost-of-service regulation gives rise to items that meet the definition of an asset or a liability in the Framework. However, the Board asked the staff to provide further analysis to clarify whether the nature of the asset is financial or intangible, and, if intangible, whether and how this asset is distinguishable from the entity's operating license. At a future meeting, the staff will present recommendations on recognition, measurement, and disclosure.

Annual improvements

Annual improvements – 2008

The Board redeliberated two issues from the August 2008 exposure draft of proposed Improvements to IFRSs and reached the following tentative decisions:

- To amend paragraph 23 of IFRS 8, *Operating Segments*, to clarify that an entity would report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker.
- To amend paragraphs 97 and 100 of IAS 39, *Financial Instruments: Recognition and Measurement*, to clarify that gains and losses on cash flow hedges recognized in other comprehensive income would be reclassified from equity to profit or loss as a reclassification adjustment in the same period or periods that the hedged forecast cash flows affect profit or loss.

The Board also reconsidered the transition requirements for classification of land leases (IAS 17). It tentatively decided that when adopting this amendment, an entity would retrospectively

- Reassess whether unexpired land leases are operating or finance leases on the basis of conditions at the inception of the lease
- Recognize land leases that are now finance leases on the basis of the fair value of the land at the inception of the lease

In addition, the Board reached a tentative decision not to require retrospective application of the amendment when information at the inception of the leases is not available. Instead, an entity would reassess the classification of unexpired land leases on the basis of conditions as of the adoption date and recognize any leases newly classified as finance leases on the basis of fair value determined as of the adoption date.

The issues discussed above will be included in the Improvements to IFRSs to be issued in April 2009.

Annual improvements – 2009

The Board reached a tentative decision to include in the August 2009 exposure draft an issue regarding presentation of the reconciliation of each item of accumulated other comprehensive income in the statement of changes in equity. The Board proposed an amendment to paragraph 106 of IAS 1, *Presentation of Financial Statements*, to clarify its original intention that the required amounts may be presented either in the statement of changes in equity or disclosed in the notes.

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

Future Board meetings

The IASB held a subsequent meeting on March 16-20, 2009 and an IASB/FASB joint meeting will be held on March 23-24, 2009. The next IASB meeting is April 20-24, 2009.

IASB enhances financial instruments disclosures

On March 5, 2009, the IASB [announced](#) the issuance of *Improving Disclosures about Financial Instruments (Amendments to IFRS 7, Financial Instruments: Disclosures)* (the Amendments), which is part of the IASB's response to the credit crisis. The objective of the Amendments is to explain more clearly how entities determine the fair value of their financial instruments and to improve the disclosure of liquidity risk.

Fair value measurement disclosures

The three-level fair value hierarchy

In order to improve the disclosure of how entities measure the fair value of their financial instruments, the Amendments introduce a fair value hierarchy that is similar, but not identical, to that which is required under FASB Statement 157, *Fair Value Measurements*. The IASB concluded that such a hierarchy would improve comparability between entities about the effects of fair value measurements as well as increase the convergence of IFRS and U.S. GAAP.

The fair value hierarchy consists of the following:

- *Level 1*: Quoted prices (unadjusted) in active markets for identical assets or liabilities
- *Level 2*: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)

- *Level 3*: Inputs for the asset or liability that are not based on observable market data (unobservable inputs)

The level in the fair value hierarchy is determined by the lowest level input that is significant to the fair value measurement in its entirety.

The disclosures required

For financial instruments within the scope of IFRS 7 which are measured at fair value in the statement of financial position, an entity shall disclose the following for each class of financial instruments:

- The level in the fair value hierarchy (as defined above) into which the fair value measurements are categorized in their entirety
- Separately, any significant transfers from Level 1 to Level 2 and from Level 2 to Level 1 of the fair value hierarchy and the reasons for those transfers. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities.
- For fair value measurements in Level 3 of the fair value hierarchy, a reconciliation from the beginning balances to the ending balances. As well as highlighting purchases, sales, and gains and losses, this reconciliation will identify transfers into or out of Level 3 and the reasons for those transfers. Significant transfers into Level 3 shall be disclosed and discussed separately from significant transfers out of Level 3.
- The effects of a change in assumptions whenever changing one or more inputs to fair value measurements in Level 3 to a reasonably possible alternative assumption would change fair value significantly.

The quantitative disclosures are to be provided in a tabular format unless another format is more appropriate. Examples have been added to the

Implementation Guidance section of IFRS 7 to illustrate some possible ways of disclosing the additional information required.

Liquidity risk disclosures

The Amendments improve the liquidity risk disclosures required by paragraph 39 of IFRS 7 by requiring an entity to disclose.

- A maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities
- A maturity analysis for derivative financial liabilities that includes the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows.
- A description of how it manages the liquidity risk inherent in derivative and non-derivative financial liabilities.

Liquidity risk is defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The most important change compared to the previous IFRS 7 liquidity risk disclosures relates to derivative financial liabilities. Previously, entities were required to disclose a quantitative maturity analysis for all derivative financial liabilities according to their remaining contractual maturities. The change is a response to comments that the requirement to provide disclosures based on the remaining contractual maturities was difficult to apply for some derivative financial liabilities and did not always result in information that reflects how many entities manage liquidity risk for such instruments. As a result, the Amendments retain the requirement to disclose the remaining contractual

maturities of derivative financial liabilities only when the information is essential for an understanding of the timing of the cash flows.

Effective date

The Amendments are effective for annual periods beginning on or after January 1, 2009. In the first year of application, however, an entity need not provide comparative information with respect to the disclosures required by the Amendments. Earlier application is permitted.

The new three level fair value hierarchy should help investors and other users to understand more clearly how entities have determined the fair value of their financial instruments. It also increases the comparability of IFRS with U.S. GAAP.

The revised liquidity disclosures should provide better information on how entities manage liquidity risk in relation to derivatives they hold.

IASB issues request for views on proposed FASB guidance regarding fair value measurement and impairments of financial instruments

The IASB [announced](#) the issuance of its [Request for views](#) on proposed FASB guidance regarding fair value measurement and impairments of financial instruments. Both of the FASB's proposals are in the form of draft Staff Positions (FSPs) and are intended to provide additional application guidance. The FASB comment period is for 15 days and ends on April 1, 2009.

The following proposals are available on the [FASB website](#):

- Proposed FSP FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*
- Proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments*

The IASB believes that in light of its commitment to work jointly with the FASB to address issues arising from the global financial crisis, it would be useful to seek views from interested parties on the FASB's proposed FSPs before issuing formal proposals for comment. The IASB would like to receive views by April 20, 2009. It should be noted that the request for views is not an IASB due process document. Any action taken by the IASB will be subject to the IASB's due process.

Note: See the [March 23, 2009 issue of *On the Horizon*](#) for a more detailed summary of the proposed FSPs.

IASB and FASB issue joint discussion paper on lease accounting

The IASB and the FASB (the Boards) [announced](#) the issuance of a joint [Discussion Paper](#), *Leases: Preliminary Views*, which is a response to concerns

raised by investors and other users of financial statements with respect to the treatment of lease contracts under IFRS and U.S. GAAP. The Boards also issued a [Snapshot](#) that briefly summarizes the major ideas of the Discussion Paper.

The Boards propose that lease accounting should be based on the principle that all leases give rise to liabilities for future rental payments and assets (the right to use the leased asset) that should be recognized in an entity's statement of financial position. This objective of this approach is to ensure that leases are accounted for consistently across all sectors and industries. The Boards have not yet discussed the method of transition or the effective date. Those issues will be discussed after comments are received on the Discussion Paper, and included in a subsequent exposure draft of the proposed standard. The comment period ends on July 17, 2009.

Note: See the [March 23, 2009 issue of *On the Horizon*](#) for a more detailed summary of the Discussion Paper.