

IFRS News

Convergence Update

July 2010 (Special Edition)

“We welcome the IASB’s and FASB’s continued efforts to pursue convergence between IFRS and US GAAP. Convergence will go a long way towards achieving a single set of high-quality, global accounting standards – a G-20 demand and a goal we support.

Inevitably, the convergence programme will lead to major changes in IFRS. The Board’s latest update aims to respond to stakeholders’ concerns by trimming their programme and extending some deadlines. But the changes are still extensive. Although implementation is still some way off, companies need to be assessing the impact now if they want to influence the outcome and avoid unwelcome surprises.”

Andrew Watchman

Executive Director of International Financial Reporting

Eighteen new standards?

Modified convergence strategy delays pace but not scale of change

The IASB and US Financial Accounting Standards Board (FASB) have announced a modified convergence strategy in response to widespread concern that they were taking on too much. Under their revised plans, a phased approach to the publication of Exposure Drafts will be adopted and the completion of lower priority projects will be delayed.

Despite this announcement, the IASB’s printing presses will remain in overdrive. Seven Exposure Drafts are due to be published in the second half of 2010, and up to eighteen new IFRSs could potentially be issued before the end of 2011. Many of these projects are driven by the desire to achieve global convergence in accounting standards.

This special edition of IFRS News informs you about the upcoming proposals – the current direction, status and next steps. We think it’s critical that companies start to assess how these changes might affect them now. Companies can then seek to make their voices heard on the proposals that will affect them the most – and begin to plan for implementation.



Structure of the newsletter

The newsletter is divided into sections. We look first at how convergence with US GAAP is influencing the IASB's work plan before considering the various projects that the IASB has in progress. For ease of navigation, these individual projects have been grouped together under the following section headings:

- financial instruments
- consolidations
- revenue recognition
- leasing
- financial statement presentation
- and other projects.

We conclude with a table which sets out the IASB's project timetable, and information on how to participate in the consultation process.

Where an Exposure Draft or other document is planned for publication, we have used the following colour coding to indicate its commercial significance.

High

Medium

Low



Convergence

The Exposure Drafts scheduled for publication in the second half of 2010 (see our timetable at the back) are significant not just in terms of their subject matter but also in number. No fewer than seven Exposure Drafts are due to be published, some of them dealing with major projects.

Furthermore, up to eighteen new IFRSs are scheduled for publication between now and the end of 2011.

The background to this unprecedented level of activity is partly political. In the wake of the financial crisis of 2008, the G-20 (the Group of Twenty Finance Ministers and Central Bank Governors) had identified differences in IFRS and US accounting standards as potential impediments to the improved regulation of the financial sector. The G-20 therefore called on the IASB and the FASB (its US counterpart) to complete their convergence plan by June 2011. To meet this June deadline, the IASB and FASB had originally planned to publish eleven Exposure Drafts in the second part of 2010.

convergence is critical to the political acceptance of IFRS in the US. The challenge for the Boards however is not only to deliver many new standards but to build consensus among current IFRS users on the need for changes on this scale.

Convergence brings many benefits. With the United States set to decide in 2011 on whether IFRS will be incorporated into the US financial reporting system, convergence is critical to the outcome of that decision. Even without US adoption, convergence takes us closer to a single, global financial reporting language. By working together, the two Boards can bring more resources to bear to deliver high quality solutions.

There was however a widespread feeling that the IASB and the FASB were taking on too much with their original plans. In response to this concern the two Boards announced a modified convergence strategy at the end of June 2010. The modified strategy retains the target completion date of June 2011 or earlier for those projects where the Boards believe improvement is needed the most. For lower priority projects or ones where further research and analysis is necessary, the target completion date has been extended. This special edition of IFRS News considers the revised work plan.

Whatever decisions are made, there seems little doubt that the next eighteen months will be critical. The challenge for the Boards is not only to deliver many new standards – they must also build consensus on the need for changes on this scale.

Financial instruments

This section provides a summary of the various projects related to financial instruments.

IFRS 9

The first chapter of IFRS 9 'Financial Instruments' was published in November 2009. This completed the initial phase of the IASB's project to replace IAS 39 'Financial Instruments: Recognition and Measurement' in its entirety.

At the moment, IFRS 9 addresses only the classification and measurement of financial assets (see box for developments relating to liabilities). IFRS 9 aims to reduce the complexity in accounting for financial instruments by having fewer categories of financial assets and a principle-based approach to their classification.

Under the new Standard, entities are required to classify a financial asset at either amortised cost or fair value on the basis of:

- a) the entity's business model for managing the financial asset; and
- b) the contractual cash flow characteristics of the financial asset (unless it chooses to designate the financial asset at fair value through profit or loss).

Chapters will be added to IFRS 9 as and when the other phases of the project are completed (see following boxes).

Financial Instruments – Liability classification and measurement

Exposure Draft: issued May 2010 (Final Standard: expected Q2 2011)

The Exposure Draft follows the work that has already been completed in IFRS 9 on the classification and measurement of financial assets. The proposals would alter the accounting for financial liabilities where the fair value option is selected, but otherwise the existing measurement requirements of IAS 39 would be retained. This reflects views expressed by many investors and other interested parties that the existing requirements for financial liabilities work well, except for the effects of changes in the credit risk of a financial liability ('own credit') when measured at fair value.

Summary of expected proposals

The Exposure Draft contains the following proposals:

- IAS 39's fair value option (FVO) would be retained
- for all financial liabilities designated under the FVO, the total fair value change of the liability would be recognised in profit or loss. The portion of the fair value change due to own credit would be reversed out of profit or loss and recognised in other comprehensive income (OCI)
- no other changes are proposed for financial liabilities. The proposals will therefore affect only those entities that choose to apply the FVO to their financial liabilities
- IAS 39's existing bifurcation requirements would be retained, so that those entities who prefer to bifurcate financial liabilities when relevant may continue to do so.

Commercial impact: Low

Apart from the change to the treatment of changes in 'own credit' for liabilities measured under the Fair Value Option, the status quo on the classification and measurement of financial liabilities will be maintained. Use of the Fair Value Option for liabilities is quite rare beyond larger financial institutions.

Amortised cost and impairment

Exposure Draft: issued November 2009 (Final Standard: expected Q2 2011)

Phase 2 of the IASB's project to replace IAS 39 commenced in November 2009 with the issue of an Exposure Draft entitled 'Financial Instruments: Amortised Cost and Impairment'.

IAS 39 currently uses an incurred loss model for the impairment of financial assets. This model, which assumes that all loans will be repaid until evidence to the contrary (a loss or trigger event) is identified, was widely criticised in the wake of the financial crisis. The Exposure Draft proposes a so-called 'expected loss model' to address some of the criticisms.

Commercial impact: High

By defining amortised cost as an amount that includes an estimate of expected credit losses, the Exposure Draft adopts an expected loss model for impairment of financial assets. This will result in revenue being reduced from inception to reflect expected future credit losses.

For financial institutions, the expected loss model is considered to be more in line with the economics of lending businesses. It will however result in additional operational complexity and costs for those businesses.

In addition, the proposals affect any assets that are held at amortised cost. They will therefore impact commercial and industrial companies that hold trade receivables or invest in financial assets to manage their liquidity. Insurance companies that invest in financial assets to cover their insurance liabilities will also be affected. The proposals may then result in additional complexity and costs for those companies as well. The IASB will however attempt to mitigate this by including 'practical expedients' in the final Standard.

Balance sheet netting of derivatives and other financial instruments

Exposure Draft: expected Q4 2010 (Final Standard: expected Q2 2011)

In response to stakeholders' concerns, the IASB and FASB plan to jointly issue an Exposure Draft which will propose changes to the requirements relating to the balance sheet netting of derivative contracts and other financial instruments, and related disclosures. The proposals aim to address differences between IFRS and US GAAP that can result in material differences in financial reporting by financial institutions.

Commercial impact: Low

Only entities that hold large volumes of derivatives and other contracts covered by master netting agreements are likely to be affected significantly. Where changes do need to be made there may be an impact on gearing and performance ratios.

Financial Instruments – Hedging

Exposure Draft: expected Q3 2010 (Final Standard: expected Q2 2011)

Phase 3 of the IASB's project to replace IAS 39 is intended to improve the decision-usefulness of financial statements for users by fundamentally reconsidering the current hedge accounting requirements.

Tentative decisions reached by the IASB indicate replacing fair value hedge accounting by permitting recognition outside profit or loss of gains and losses on financial instruments designated as hedge instruments (an approach similar to cash flow hedge accounting). Some simplification of the current cash flow hedge accounting model is also expected.

Commercial impact: Medium

The IASB's proposals could significantly change the conditions for using hedge accounting and also its accounting presentation. Companies using hedge accounting may need to adapt to new rules for designating hedges and measuring their effectiveness. However hedge accounting will of course remain optional. Many companies will therefore be entirely unaffected, although the impact on others (such as banks) could be profound.

Other financial instruments projects

In addition to the phased project to replace IAS 39 described on the previous pages, the IASB currently has a number of other projects in progress.

Derecognition – disclosures

Final Standard: expected Q3 2010

Following comments received on the IASB's March 2009 Exposure Draft 'Derecognition', the IASB has decided that the near-term priority for this project should be to

- improve the disclosure requirements for financial assets transferred to another entity, and
- converge with US GAAP disclosure requirements.

To this end, the IASB plans to finalise improved disclosure requirements for derecognition in Q3 2010.

The original proposals for revising IAS 39's derecognition requirements have however been suspended for the moment. This is partly because the existing derecognition requirements were seen as having performed favourably during the financial crisis. The IASB and FASB will instead conduct additional research analysis (including a post-implementation review of FASB's recently amended requirements in this area) as a basis for assessing the nature and direction of any further efforts to improve or converge IFRSs and US GAAP. It is expected that a decision will not be made on this part of the project until 2012.

Commercial impact: Low

The Exposure Draft will be limited to improving disclosure requirements for financial assets transferred to another entity. Potentially significant changes to the derecognition criteria for financial assets will not now be made in the near future.

Financial Instruments with characteristics of equity Exposure Draft: expected Q1 2011 (Final Standard: expected Q4 2011)

When an entity issues a financial instrument, it must determine its classification either as a liability (debt) or as equity. That determination has an immediate and significant effect on the entity's reported results and financial position. Liability classification affects an entity's gearing ratios and typically results in any payments being treated as interest and charged to earnings. Equity classification avoids these impacts but may be perceived negatively by investors if it is seen as diluting their existing equity interests. The classification process and its effects are therefore critical issues.

An Exposure Draft will develop a model that uses the current IFRS model as a starting point and acknowledges that certain amendments are required to address known issues with that approach

Currently this issue is addressed by IAS 32 'Financial Instruments: Presentation'. The IASB and the FASB are however working jointly to develop a comprehensive standard that will simplify and improve the financial reporting requirements in this area. The two Boards published a Discussion Paper 'Financial Instruments with the Characteristics of Equity' in February 2008, but subsequently decided not to pursue any of the approaches proposed in that document. Instead an Exposure Draft will develop a model that uses the current IFRS model as a starting point and acknowledges that certain amendments are required to address known issues with that approach.

By early 2010, the boards had jointly developed a proposed standard. External stakeholders that reviewed a staff draft of that proposal raised concerns however about the meaning, enforceability, and internal consistency of some of the proposed requirements. As a result, the IASB and the FASB have decided that more time is required to work through these issues and an Exposure Draft is now expected to be published in the first quarter of 2011.

Commercial impact: Medium

The eventual proposals are not expected to be fundamentally different to IAS 32 and will not alter the classification of many instruments issued by entities reporting under IFRS (NB there may be significant changes to the classification model under US GAAP). At this stage, we expect that the entities most likely to be affected will be those with more complex capital structures. Where classification does change, the effect on leverage ratios and reported earnings is typically substantial.

Financial Instruments – IASB request for views on FASB financial instruments proposals (Request for views: issued May 2010)

In addition to its own proposals the IASB is seeking views on the FASB's comprehensive Exposure Draft on financial instrument accounting. The views received will influence the IASB as it undertakes its own comprehensive review of financial instruments. At present different approaches are being taken by the two Boards – the FASB is following a (mainly) full fair value measurement model with the IASB retaining a mixed measurement approach.



Consolidations

The IASB's Consolidations project is designed to be a comprehensive review of off-balance sheet activities. The project comes in the wake of the financial crisis and reflects concerns that some companies ended up providing support to special purpose entities (SPEs) that they had previously not consolidated.

The G-20 and other commentators had questioned whether the current requirements in this area resulted in the right things being brought onto the balance sheet. In particular, there was concern that financial statements do not convey the extent to which reporting entities are exposed to risks from structured entities.

The project objective is to publish a single IFRS on consolidation that would replace IAS 27 'Consolidated and Separate Financial Statements' and SIC 12 'Consolidation – Special Purpose Entities'. As things currently stand, there is tension between the models used in these two pronouncements, with IAS 27 focusing on whether one entity controls another, while SIC-12 uses a mixture of tests of control and of risks and rewards. Inevitably this tension between the two models has led to inconsistent application and created structuring incentives. In addition to the planned replacement of IAS 27, the IASB also plans to release a separate comprehensive disclosure standard related to involvement with other entities and an Exposure Draft of proposed changes to its consolidation requirements relating to investment entities.

Consolidations – IASB disclosures about unconsolidated SPEs/structured entities

Final Standard: expected Q4 2010

Summary of expected proposals

- the IFRS will enhance disclosures about consolidated and unconsolidated entities
- in particular, disclosures are expected to address risks associated with structured entities that the reporting entity does not control.

Commercial impact: Medium

The IFRS will address an important subject but will be limited to disclosures. However, the disclosures will be extensive for entities that have significant involvement with so-called structured entities.

Consolidations – investment entities

Exposure Draft: expected Q4 2010 (Final Standard: expected Q2 2011)

The IASB will issue a separate Exposure Draft addressing the consolidation of investment entities. The objective of the Exposure Draft will be to define an investment entity and to require that an investment entity should not consolidate investments in entities that it controls, but to measure those investments at fair value, with changes in fair value recognised in profit or loss.

Commercial impact: High (for some investment entities)

The proposals will only affect those investment entities that exercise control over individual investments. While many investment entities may therefore be unaffected, some will face a major change to the way that they prepare their financial statements. The IASB's definition of "investment entity" will also be critical.

Consolidations – replacement of IAS 27

Final Standard: expected Q4 2010

Summary of expected proposals

- the IASB will aim to revise the definition of control in order to make it more robust, and to address the perceived inconsistencies between IAS 27 and SIC-12
- the revised Standard is expected to state that a reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity.
- the IASB has tentatively decided that power refers to a reporting entity's current ability to direct the activities of an entity that significantly affect the returns.

Commercial impact: Medium

The revised Standard is likely to leave the accounting assessment of whether or not an entity should be consolidated unchanged in the majority of situations (see opposite page for investment entities however).

In more complicated situations, such as those involving special purpose entities or where control is being assessed in the absence of majority voting rights, there could be an impact. Any such impact would by nature be a large one (leading to consolidation or non-consolidation of the entity in concern). The IASB has also tentatively concluded that the fact that control of an entity might only be temporary, will not be reason for not consolidating it.

Convergence:

In addition to publishing a staff draft of the proposed IASB standard, FASB is also expected to publish an Exposure Draft on consolidation in the third quarter of 2010. The IASB will publish a request for views on the FASB proposal. The two boards will jointly deliberate the issue with the expectation that they will produce improved and converged standards in the fourth quarter of 2010).

Joint Ventures

Final Standard: expected Q3 2010

In addition to the project to replace IAS 27 and SIC 12, the IASB has a project in progress that would replace IAS 31 'Interests in Joint Ventures'. The project is not being undertaken in association with the FASB, although it would eliminate the use of proportionate consolidation, which is the major difference between IFRS and US GAAP in this area.

Summary of expected requirements

The Final Standard is expected to:

- remove the ability to use proportionate consolidation for joint ventures on the basis that equity accounting provides a more representative portrayal of the assets the reporting entity controls
- merge the current categories of jointly controlled operations and jointly controlled assets into a single type of joint arrangement called a 'joint operation'.

Commercial impact: Medium

The expected requirements are likely to have little effect on arrangements that involve jointly controlled operations or jointly controlled assets. The likely elimination of the option of using proportionate consolidation to account for interests in jointly controlled entities can however be expected to have a significant impact on the many entities currently using it.

Although net assets will not be affected by the elimination of proportionate consolidation, the removal of that method of accounting would have a significant effect on the costs of preparing the financial statements. It is also likely to affect individual balance sheet and performance ratios.

Revenue recognition

Revenue recognition

Exposure Draft: issued June 2010 (Final Standard: expected Q2 2011)

Revenue recognition is a perennial problem in the world of accounting, and the IASB and the FASB have been working together for some time now with the aim of providing a single revenue recognition model for their constituents.

Revenue recognition literature in US GAAP and IFRS is currently quite different, with both being considered in need of improvement. Under US GAAP, revenue recognition requirements are found in various standards, many of which are industry-specific. Some of these standards can produce conflicting results for transactions which are in fact economically similar. While IFRS contains fewer standards on revenue recognition, the two main standards (IAS 18 'Revenue' and IAS 11 'Construction Contracts') have been criticised for being inconsistent and being difficult to apply beyond simple transactions.

The objective of the Exposure Draft is to improve the existing guidance under both IFRS and US GAAP by developing a single revenue model that can be applied consistently regardless of industry.

Summary of expected proposals:

The Exposure Draft proposes a single, contract-based model for revenue recognition. The core principle is to recognize revenue as performance obligations are satisfied. This in turn occurs when control of an asset (whether a good or service) transfers to the customer.

To effect this principle, an entity would first of all need to identify the contract with a customer and the distinct performance obligations in the contract. It would then need to determine the transaction price, and allocate that price to the performance obligations. Revenue would be recognised when a performance obligation is satisfied.

The proposed model also specifies the accounting for some costs associated with contracts with customers.

Commercial impact: High

It is anticipated that accounting for very simple, single obligation-type contracts would not be affected (such as basic retail transactions and short-term service contracts). In many circumstances, however, the new model will require changes in revenue recognition policies. For example:

- revenue recognition for construction contracts would only occur during construction if the customer controls the item as it is constructed
- entities would account for contractual promises (eg insurance-type warranties and other post-delivery services) as performance obligations and would recognise revenue when these obligations are satisfied
- costs such as commission paid to sales staff for obtaining a contract with a customer will be expensed unless they qualify for capitalisation in accordance with other standards.

Leasing

Leasing

Exposure Draft: expected Q3 2010 (Final Standard: expected Q2 2011)

The question of where to 'draw the line' between on-and off-balance sheet leases has exercised accountants for decades. That line may soon cease to exist. Following last year's Discussion Paper 'Leases: Preliminary Views', an Exposure Draft is expected to be published imminently.

Summary of expected proposals:

It is expected that the Exposure Draft will propose:

- eliminating the requirement to classify a lease contract as an operating or finance lease
- a single accounting model would instead apply for all leases, with a lessee recognising a 'right of use asset' representing its obligation to pay lease rentals
- the individual components of a lease contract (such as options to renew, purchase options, contingent rental arrangements or residual value guarantees) would not be recognised separately. Instead, entities would recognise a single right-of-use asset and a single obligation to pay rentals that reflects expected outcomes
- a new hybrid accounting model for lessors, under which leases that expose the lessor to significant risks and benefits associated with the underlying asset will be accounted for using a performance obligation approach, while a derecognition approach will be used for all other leases.

The proposals on lessee accounting are a response to concerns raised by investors and other users of financial statements about the current lease accounting model. Under IAS 17 'Leases', a distinction is made between finance leases (on-balance sheet) and operating leases (off-balance sheet, with lease payments simply recognised as an expense over the lease term). As a result, two quite similar leases may be accounted for very differently. This affects comparability and creates well-publicised incentives to design leases to fall just within the operating (off-balance sheet) category.

Sir David Tweedie, IASB Chairman, has commented on the problems created by the difference in treatment between finance and operating leases on a number of occasions. Most memorably he remarked on his ambition, before he dies, to fly in an airplane that is shown on the airline's balance sheet.

More generally, many users of financial statements back the assertion that all lease contracts give rise to assets and liabilities. The proposals in the Exposure Draft are expected to reflect this, aiming to ensure that leases are accounted for consistently across sectors and industries. Nonetheless, removing the off-balance sheet operating lease classification will be controversial and the leasing industry and major lessees may not be so supportive.

Commercial impact: High

Recognising all leases in the Statement of Financial Position could lead to substantial increases in reported assets and liabilities for entities that use operating leases, with consequent implications for assets and performance ratios.

The proposals can also be expected to have significant compliance implications for many entities which rely on leasing. Regulated entities may for example need to hold more capital to compensate for the increased assets recognised on their Statement of Financial Position.

More generally, the increased value of assets and liabilities recognised in the Statement of Financial Position may have an effect on the structuring of future transactions. The effect on loan agreements and bank covenants may need to be considered for example. Debt to equity ratios and other calculations of leverage may also be affected by separating operating lease expense into interest expense and capital repayment elements.

The proposals can also be expected to add to the costs of preparing an entity's financial statements, due to the increase in complexity and greater subjectivity that will be introduced by the proposals.

Disclosures about discontinued operations

Exposure Draft: expected Q1 2011 (Final Standard: expected Q4 2011)

As part of the Financial Statements project, the IASB and the FASB have been considering the definition of discontinued operations and the related disclosure requirements with the aim of achieving convergence. With this in mind, an Exposure Draft to amend IFRS 5 was originally published in September 2008.

Summary of expected proposals

After considering respondents' comments to this earlier Exposure Draft, the IASB has decided to re-expose its proposals. The new Exposure Draft is expected to propose a common definition of a discontinued operation for IFRS and US GAAP that is based on the current definition in IFRS 5.

Disclosures should be provided if an entity retains continuing involvement with a discontinued operation after the disposal date.

Commercial impact: Low

The proposal will only affect those entities with operations that will meet the new definition of discontinued operations, leaving the majority of entities unaffected.

Replacement of IAS 1 and IAS 7

Exposure Draft: expected Q1 2011 (Final Standard: expected Q4 2011)

This section of the project addresses fundamental issues concerning the presentation of information in the financial statements, including aggregating and disaggregating information in each financial statement, defining totals and subtotals, and considering the use of a direct or an indirect method of presenting operating cash flows.

Summary of expected proposals

The Exposure Draft is expected to follow on from the IASB's earlier discussion paper, which proposed a presentation model that requires an entity to present information about the way it creates value (its business activities) separately from information about the way it funds or finances those business activities (its financing activities).

The proposed presentation model is designed to make an entity's financial statements more useful by requiring entities to provide detailed information organised in a manner that clearly communicates an integrated financial picture of an entity.

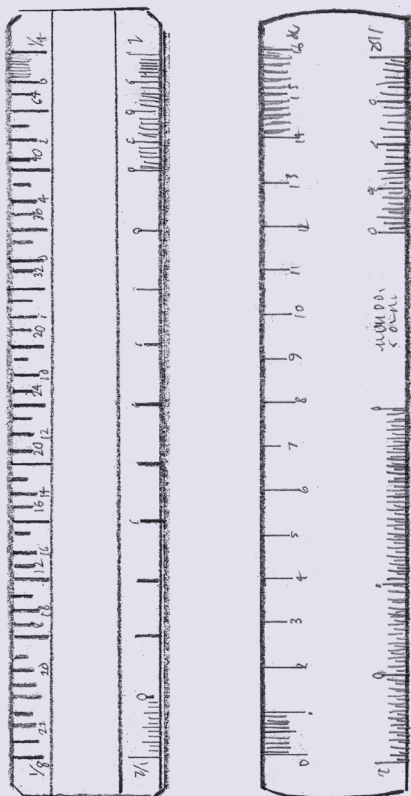
The discussion paper proposed that an entity should use the direct method to present cash flows in its Statement of Cash Flows, and this proposal may well be included in the Exposure Draft when it is eventually published.

Commercial impact: High

Although the proposals relate only to presentation and disclosure, they will have a profound effect on companies' primary financial statements. Management will need to reassess the classification of income, expense, assets, liabilities and cash flows in accordance with a new model. The level of (dis-)aggregation will need to be reviewed. Significant judgement will be required. There may also be systems implications (in particular if use of the direct method for the Statement of Cash Flows is made mandatory). If the proposal is endorsed, this is likely to add to the cost and complexity of preparing the financial statements in the year of initial adoption.

Other projects

As well as the projects discussed in the preceding sections of the newsletter, Exposure Drafts have been published or are expected to be published shortly on a number of other projects that the IASB has in progress. We outline these below.



Pension accounting

Exposure Draft: issued April 2010 (Final Standard: expected Q1 2011)

Summary of proposals:

The proposed amendments aim to address deficiencies in the accounting for defined benefit plans under IAS 19 'Employee Benefits' by requiring entities:

- to account immediately for all estimated changes in the cost of providing these benefits and all changes in the value of plan assets (ie removing what is often referred to as the 'corridor' method of accounting under which pension deficits and surpluses are spread in the profit or loss)
- to use a new presentation approach that would clearly distinguish between different components of the cost of these benefits
- to disclose clearer information about the risks arising from defined benefit plans.

Commercial impact: Medium

Although the proposals are limited, they will have a significant impact on the reported results of companies that currently use the 'corridor' method of accounting for their defined benefit plans. Such entities would no longer be able to spread the effects of a pension deficit or surplus in the profit or loss account. The impact is however mitigated by the facts that:

- defined benefit plans have become less common
- the corridor method is only one of the accounting policy options available in IAS 19.

Fair value measurement

Exposure Draft: issued June 2010 (Final Standard: expected Q1 2011)

An Exposure Draft on 'Measurement Uncertainty Analysis Disclosure for Fair Value' has been published. This Exposure Draft is part of the bigger project to align fair value measurement in IFRSs and US GAAP.

An Exposure Draft dealing with the overall issue of fair value measurement and disclosure was published in May of last year. That earlier Exposure Draft addressed the definition of fair value, aiming to establish a framework for measuring fair value and making disclosures about fair value measurements (currently the guidance on fair value measurement is dispersed across many IFRSs and is not always consistent between standards).

The new Exposure Draft re-exposes one part of the earlier proposals – the proposed requirement for an entity to disclose a measurement uncertainty (sensitivity) analysis about Level 3 fair value measurements. This follows the IASB's tentative decision to require an entity to consider the expected effects of correlation between inputs in that analysis. The requirement to consider correlation between inputs was not included in the earlier Exposure Draft.

Should the overall project be completed (a final Standard is planned for Q1 2011), it would replace fair value measurement guidance contained in individual IFRSs with a single, unified definition of fair value and supporting guidance. It would also result in convergence with US GAAP, the aim of both the IASB and FASB being to ensure that fair value has the same meaning in US GAAP and IFRSs.

Summary of expected proposals

- the Exposure Draft is limited in its scope. It re-exposes the proposed requirement for an entity to disclose a measurement uncertainty (sensitivity) analysis about Level 3 fair value measurements given the boards' tentative decision to require an entity to consider the expected effects of correlation between inputs in that analysis.

Commercial impact: Medium

The Exposure Draft will not affect the types of asset and liability for which IFRS requires fair value measurement, nor will it change the concept of fair values. The eventual Standard will however replace and significantly expand the existing guidance on how to estimate fair values. For measurements not derived entirely from quoted prices in an active market, management's valuation techniques and assumptions will need to be benchmarked against the new principles and guidance.

Convergence:

The objective of both the IASB and FASB is to ensure that fair value has the same meaning in US GAAP and IFRSs. They are aiming to achieve this objective by making US GAAP and IFRS fair value measurement requirements the same other than minor necessary differences in wording or style. The two Boards are therefore deliberating issues on the project jointly, with the ultimate goal of issuing common standards.

Insurance

Exposure Draft: expected Q3 2010 (Final Standard: expected Q2 2011)

The Exposure Draft will propose a new Standard to replace IFRS 4 'Insurance Contracts' and provide a basis for consistent accounting for insurance contracts. Discussions on the project are being held jointly with the FASB.

Summary of proposals:

Tentative decisions made which may be reflected in the Exposure Draft include:

- policyholder liability shall not be subject to any floor value equal to the current surrender value
- specific guidance will be given on the release of residual margin (the margin required to ensure that the initial liability is no less than the initial premium received)
- participating business: all policyholder cash flows would be included in the measurement of the insurance liability on an expected present value basis. No split into guaranteed liabilities and those relating to future bonus would be required
- unit-linked business: unit-linked assets and liabilities should be recognised in the insurance company's balance sheet.

Commercial impact: High (for insurance companies)

IFRS 4 is an interim standard that enables insurers that have adopted IFRS to retain many of their pre-IFRS, local GAAP accounting policies. Its replacement will require most insurers to make some changes.

Income taxes

Exposure Draft: expected Q3/Q4 2010 (Final Standard: expected Q1/Q2 2011)

Following criticism of its March 2009 Exposure Draft 'Income Tax' in which it had proposed a new calculation methodology for deferred taxes, and the elimination of various exceptions to the recognition of deferred tax, the IASB plans to issue a new Exposure Draft on this subject.

The objective of the new Exposure Draft will be to resolve problems in practice under IAS 12 'Income Tax', without changing IAS 12's fundamental approach. A full review of the accounting for income tax will instead be deferred to sometime in the future.

Summary of proposals:

The new Exposure Draft is expected to consider the following practice issues:

- uncertain tax positions, but only after the revision of IAS 37 is finalised
- deferred tax on property remeasurement at fair value.

It is also expected to introduce several proposals from the March 2009 Exposure Draft that were generally supported such as the introduction of an initial step to consider whether the recovery of an asset or settlement of a liability will affect taxable profit.

Commercial impact: Medium

Although the Exposure Draft is expected to propose limited amendments to the current Standard, those amendments may nevertheless be significant for some entities.

Should the Exposure Draft, for example, propose the measurement of uncertain tax positions using a probability weighted average amount, this would be a significant change for companies. Currently many companies adopt an 'all or nothing' approach to this area. Determining the range of possible outcomes for individual tax positions and the likelihood of those outcomes occurring would be a difficult task for some companies.

Liabilities

Final Standard: expected Q1/Q2 2011

In January 2010, the IASB issued an Exposure Draft 'Measurement of Liabilities in IAS 37' with the aim of replacing the current version of IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'. The IASB is undertaking the project to:

- improve the guidance on identifying liabilities
- reduce differences between IAS 37 and US GAAP
- make the recognition requirements for liabilities in the scope of IAS 37 consistent with those for other liabilities.

A particular concern has been the proposal to remove the criterion in IAS 37 under which an obligation is recognised as a liability only if it is probable (ie more likely than not) that there will be an outflow of resources. Under the proposed Standard, an entity would estimate the expected value to fulfil its obligation (ie the probability-weighted average of the outflows for the range of possible outcomes). The proposed change would particularly affect companies in litigation-prone industries.

The comment period on the Exposure Draft is now closed. The IASB will consider the comments received and plans to issue a final IFRS in the first half of 2011.

Commercial impact: High

The overall changes are sufficiently wide for many businesses to be affected. Although there will be limited changes to how some existing liabilities are measured, a significant change will be the elimination of the concept of a contingent liability. Many situations that are currently considered to be contingent liabilities will in future result in recognition of actual liabilities in the statement of financial position.

Rate-regulated activities

Final Standard: expected Q1/Q2 2011

The objective of the IASB's project on rate-regulated activities is to clarify whether regulated entities should recognise an asset or a liability as a result of rate regulation. Rate regulation itself is a restriction in the setting of prices that can be charged to customers for services or products. Generally, it is imposed by regulatory bodies or governments when an entity has a monopoly or a dominant market position that gives it excessive market power.

Following the publication of an Exposure Draft in July 2009, the IASB has not as yet made any decisions on specific aspects of the project other than to finalise transition relief* for first-time adopters in its 'Improvements to IFRSs' issued in April 2010.

Commercial impact: High (for rate-regulated entities)

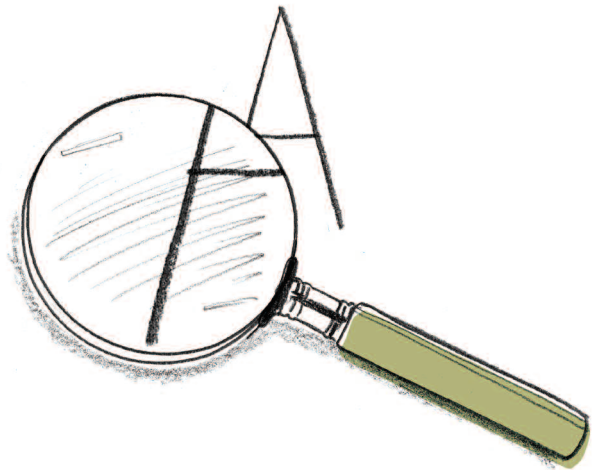
Although the scope of this project is by its nature limited, rate regulation is widespread and significantly affects the economic environment of rate-regulated entities. Many billions of dollars of 'regulatory' assets and liabilities are currently recognised in jurisdictions that currently refer to US GAAP but which are moving to IFRS. For those entities, the outcome of this project will be very significant then.

* The transition relief permits entities with operations subject to rate regulation to use the carrying amount of the items of property, plant and equipment or intangible assets determined under the entity's previous GAAP as deemed cost at the date of transition to IFRS.

The IASB's project timetable

Timetable for publication of IASB documents

	2010	Q3	Q4	2011	Q2	H2
	Q2			Q1		
Financial instruments:						
Amortised cost and impairment*					IFRS±	
Liability classification and measurement*	ED (May)				IFRS±	
Hedging*		ED			IFRS±	
Asset and liability offsetting*			ED		IFRS±	
Request for views on FASB proposal*	RV (May)					
Derecognition – disclosures*		IFRS				
Financial Instruments with characteristics of equity*				ED		IFRS(Q4)
Consolidations:						
Disclosures about unconsolidated SPEs/structured entities			IFRS			
Replacement of IAS 27*			IFRS			
Investment entities^			ED		IFRS	
Joint ventures +		IFRS				
Fair value measurement*	ED (June)			IFRS		
Revenue recognition*	ED (June)				IFRS	
Leasing*		ED			IFRS	



Timetable for publication of IASB documents

	2010			2011		
	Q2	Q3	Q4	Q1	Q2	H2
Financial Statement Presentation						
Presentation of items of other comprehensive income *	ED (May)		IFRS			
Disclosures about discontinued operations *				ED		IFRS (Q4)
Main standard, replacement of IAS 1 and IAS 7 *				ED		IFRS (Q4)
Other Projects						
Pension accounting +	ED (April)			IFRS		
Insurance ^		ED			IFRS	
Income taxes +		ED		IFRS		
Liabilities				IFRS		
Rate-regulated activities				IFRS		

Key:

- * Project is both part of the Memorandum of Understanding between the IASB and FASB, and also a joint paper between them
- + Project is part of the Memorandum of Understanding between the IASB and FASB
- ^ Joint paper between the IASB and FASB
- ± The project will be finalised as part of IFRS 9 'Financial Instruments'

Participating in the consultation process

Obtaining the relevant papers

All of the Discussion Papers and Exposure Drafts referred to will be available on the IASB's website (www.iasb.org).

Printed copies will be available from:

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E publications@iasb.org

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If you want to influence the debate on any of the issues mentioned in this Special Edition of IFRS News, you can do this in several ways:

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