

IFRS in Brief

May 2007, **Issue 35**

This issue of *IFRS in Brief* covers the April 2007 meeting of the International Accounting Standards Board (IASB) and the April 2007 joint meeting of the IASB and the U.S. Financial Accounting Standards Board (FASB).

KPMG's monthly update on International Financial Reporting Standards (IFRSs)

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- discussed one issue for its annual improvements ED.

At the April 2007 joint meeting of the IASB and the FASB, the Boards discussed:

- a number of sweep issues on the business combinations joint project
- the scope of the leases joint project
- the measurement phase of the conceptual framework joint project
- a draft agenda proposal on the scope of the intangible assets joint project
- the liabilities and equity joint project led by the FASB.

IASB Meeting

Business Combinations

The Board continued redeliberating proposals in the ED of *Proposed Amendments to IFRS 3*, and:

Summary

At its April 2007 meeting the IASB:

- continued redeliberating proposals in the Exposure Draft (ED) of *Proposed Amendments to IFRS 3 Business Combinations*
- discussed the post-employment benefits project
- discussed the conceptual framework project
- discussed the ED *Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation*
- discussed its forthcoming ED of *Proposed Amendments to IAS 12 Income Taxes*

- with respect to an acquirer's share-based payment awards (replacement awards) exchanged for awards held by the acquiree's employees (acquiree's awards), tentatively decided:
 - that the excess of fair value of the replacement awards over the acquiree's awards should be recognised over the post-combination vesting period
 - that the fair value of the replacement awards, less the excess discussed above, should

be accounted for as follows:

- (1) for the proportion vested (calculated by comparing the vesting period completed to the greater of the total vesting period of the replacement awards and the total vesting period of the acquiree's awards), as part of the costs of acquisition;
- (2) for the proportion unvested, over the post-combinations vesting period
- that the fair value of replacement awards, to the extent unvested, should include an estimate of forfeitures
- to affirm that post-combination forfeitures are compensation expense and do not affect the cost of acquisition
- that the post-combination effects of remeasuring cash-settled replacement awards should be recognised as adjustments to compensation expense and income tax expense in the period in which they arise
- tentatively decided to allow non-controlling (minority) interests (NCI) to be recognised on a transaction-by-transaction basis, either at fair value, or at the proportionate share in the fair value of the identifiable net assets acquired
- reaffirmed that the measurement attribute in a business combination is fair value and that the definition of fair value in the current IFRS 3 will be retained
- asked the staff to include in the basis for conclusions or in the application guidance a discussion about the differences in the fair value concepts used by the FASB and the IASB
- discussed principles to determine what triggers a reassessment of the classification or designation of assets, liabilities or contracts acquired or assumed; see further discussion in the joint meeting below

- tentatively decided that the proposed standard should be applied at the same time as the proposed revised IAS 27 *Consolidated and Separate Financial Statements*, effective for annual periods beginning on or after 1 January 2009; early application will be permitted
- tentatively affirmed the disclosure requirements in the ED, but also proposed disclosure of:
 - the reasons that any contingent liabilities or contingent assets could not be measured reliably
 - information about such contingent liabilities as required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, regardless of whether outflows are considered remote
 - information about such contingent assets as required by IAS 37, regardless of whether the inflow of economic benefits is probable
- tentatively decided that IFRS 4 *Insurance Contracts* should continue to be applied to insurance contracts acquired in a business combination.

Post-employment Benefits

The Board continued discussing its project on post-employment benefits, and:

- tentatively decided that gains and losses on settlement or curtailment should be recognised as they occur, and that:
 - a curtailment gain or loss is a service cost that should be recognised in profit or loss
 - a settlement gain or loss is not a service cost because it arises from changes in financial assumptions
- tentatively decided that the project should address whether plan amendments that reduce benefits are a curtailment or a negative service cost; the staff was asked to consider the issue as a possible annual improvement

- discussed, but made no decisions on, how to classify benefits that change in relation to fixed increases in assets
- asked the staff for new definitions for asset-based, defined contribution, and defined benefit promises that would, amongst other things:
 - exclude deposit-like benefits from defined benefits
 - clarify how to treat promises of fixed increases
 - help to clarify promises based on notional assets by proposing a new term for such promises.

Conceptual Framework

The Board discussed its conceptual framework project, and:

- regarding qualitative characteristics tentatively decided that:
 - faithful representation should be retained as a required characteristic
 - verifiability should be an “enhancing” characteristic separate from faithful representation
 - the difference between an “enhancing” and a “necessary” characteristic should be clarified
 - the understandability discussion should be clarified
 - conservatism is not a component of faithful representation
- asked the staff to consider classifying timeliness as an enhancing qualitative characteristic or as a constraint to financial reporting, rather than as a component of relevance
- affirmed its decision to consider in a separate project applying the conceptual framework to not-for-profit organisations.

Financial Instruments Puttable at Fair Value

The Board discussed the ED *Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation*, and agreed with the staff's proposals that:

- the scope of the ED should be maintained

- other instruments that may create the same concerns as financial instruments puttable at fair value should be researched, which would require:
 - an understanding of the characteristics of these instruments and entity structures
 - an analysis of whether additional exemptions to IAS 32 *Financial Instruments: Presentation* are required
 - the determination of whether these other instruments should form part of the liabilities and equity project.

Income Taxes

The Board discussed its forthcoming ED of *Proposed Amendments to IAS 12*, and:

- decided that the exemption from recognising a deferred tax liability on the initial recognition of goodwill should be retained
- tentatively decided that the fair value of assets acquired and liabilities assumed should include assumptions about the tax base from a market participant's perspective rather than assuming the vendor's tax base, regardless of whether or not the transaction is a business combination.

Annual Improvements

As part of its forthcoming annual improvements ED, the Board discussed amending IAS 38 *Intangible Assets* to clarify, for advertising and promotional training materials, when to recognise the expense in relation to the delivery and also the development of such materials; the Board asked the staff to develop the issue further.

Other

The Board also:

- discussed interim steps in moving towards the fair value model for all

financial instruments, whereby the fair value measurement principle would be used as a starting point and exemptions would be made; no decisions were made

- discussed the difficulties in applying the proposals in the ED of *Proposed Amendments to IAS 37* to legal cases; no decisions were made
- decided that the definition of discontinued operations and any related disclosures should be discussed with the FASB and be separate from the financial statement presentation project; see further discussion in the joint meeting below
- discussed a draft of proposed amendments to IAS 31 *Interests in Joint Ventures* and tentatively decided that the ED should propose a revised, rather than an amended, IAS 31.

Joint Meeting of the IASB and the FASB

Business Combinations

The Boards concluded their redeliberation on the business combinations joint project by discussing a number of sweep issues, and agreed that:

- the IASB will, in the interest of convergence with the FASB, require that the off-market portion of an operating lease be recognised as an intangible asset separate from the related acquired asset
- the FASB will, in the interest of convergence with the IASB:
 - retain its guidance on the classification of long-lived assets as held for sale if the sale is expected to be completed within one year
 - require usage of the conditions that exist at the acquisition date as the general principle to determine how to classify or designate assets, liabilities or equity instruments acquired
- the FASB will require the measurement of NCI at fair value

- the IASB will allow NCI to be recognised on a transaction-by-transaction basis, either at fair value, or at the proportionate share in the fair value of the identifiable net assets acquired (see above)
- on acquisition, and subsequently, an asset for an indemnification should be measured at the same amount as the related liability
- leases and insurance contracts will be exceptions to the principle of looking to the conditions that exist at the acquisition date to determine how to classify assets, liabilities and equity instruments; leases and insurance contracts will be classified based on conditions at the inception of the contracts
- an acquirer could not designate as the effective acquisition date the end of an accounting period between the date that the acquisition is initiated and the date that the acquisition is consummated.

The staff was instructed by the Boards to begin the drafting and pre-balloting process for the revised IFRS 3 and amended IAS 27.

Leases

With respect to the leases joint project, the Boards agreed that its scope should be based on the current lease standards. The Boards may consider expanding the scope as the project progresses.

Conceptual Framework

The Boards discussed the measurement phase of the conceptual framework project, focusing on the measurement basis issues of this phase as presented by the staff. Generally, the Boards agreed with the staff's measurement basis issue recommendations, which primarily address: what the measurement basis candidates are; how they are defined; what their basic properties are; and whether they are appropriate for both assets and liabilities.

In addition, the staff was instructed by the Boards to focus on the first four phases of the conceptual framework project before beginning the presentation and disclosure phase, and before examining the application of the framework to not-for-profit organisations.

Intangible Assets

As part of their Memorandum of Understanding, the Boards discussed the scope of the intangible assets project, and agreed that it will:

- include the initial and subsequent accounting for identifiable intangible assets acquired outside of a business combination, including internally generated intangible assets
- exclude the accounting for goodwill.

A draft proposal is planned to be presented to the Standards Advisory Council (SAC) in June 2007. A final proposal is planned to be presented to the Trustees of the International Accounting Standards Committee Foundation in October 2007 and to the SAC in November 2007.

Liabilities and Equity

As part of the liabilities and equity joint project led by the FASB, the European Financial Reporting Advisory Group's PAAinE (Proactive Accounting Activities in Europe) initiative and the German Accounting Standards Board presented findings from their independent initiatives on developing a model to distinguish liabilities from equity; no decisions were made.

IASB Observer Notes

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