

IFRS in Brief

July 2007, **Issue 37**

This issue of IFRS in Brief covers the June 2007 meeting of the International Accounting Standards Board (IASB).

In addition, at its June 2007 meeting the Board:

- considered topics for its annual improvements exposure draft (ED)
- held an educational session on the extractive activities research project
- approved recent International Financial Reporting Interpretations Committee (IFRIC) activities
- reviewed the technical plan.

Business Combinations

The Board discussed four issues that arose during the drafting of the revisions to IFRS 3 *Business Combinations* and the amendments to IAS 27 *Consolidated and Separate Financial Statements*, and tentatively affirmed the following:

- For operating leases in which the acquiree in a business combination is the lessor, favourable or unfavourable operating lease terms, taking into consideration market terms at the acquisition date, should be recognised as part of the fair value of the asset subject to the operating lease. The Board is reversing the tentative decision it made in April 2007.
- Retrospective application will not be required for losses that, when allocated to a non-controlling interest in a subsidiary, result in the non-controlling interest being reported as a deficit.

Summary

At its June 2007 meeting the Board continued:

- discussing the business combinations project
- discussing the lease accounting project
- discussing the financial statement presentation project
- discussing the post-employment benefits project
- redeliberating the conceptual framework project
- discussing the joint venture project
- discussing proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*
- redeliberating the financial instruments project.

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

- For an acquirer's share-based payment awards that are exchanged for an acquiree's awards, the value of the awards should be included in the measurement of the consideration transferred in a business combination only if the acquirer is obliged to replace the acquiree awards.

In addition, the Board tentatively decided that indemnification assets should be:

- recognised only to the extent that they are collectible
- recognised and measured in the same way as at acquisition and subsequent to acquisition based on assumptions that are consistent with those used to measure the related liability.

Leases

The Board discussed the measurement of a lessee's contractual right to use a leased item (an asset) and its contractual obligation to make payments to the lessor (a liability), both on initial recognition and subsequently.

The Board tentatively concluded that a lessee's obligation to make payments to a lessor is a financial liability, as defined by IAS 39 *Financial Instruments: Recognition and Measurement*, and therefore the liability should be measured initially at fair value. The Board also tentatively concluded that subsequent to initial recognition, the liability should be measured at amortised cost using the effective interest method, unless the fair value option is elected (subject to the restrictions in IAS 39).

The Board discussed but did not conclude on possible approaches to measuring a lessee's initial and subsequent right to use an asset.

The Board pointed out that there may be situations in which there is

a significant difference between the date that a lease is signed and the date that the leased item is delivered, and that this difference could affect the measurement of lease-related assets and liabilities. The Board instructed the staff to analyse this issue further.

Financial Statement Presentation

The Board discussed alternative presentation formats for disaggregated income or expense amounts in respect of the financial statement presentation project. The Board tentatively decided that:

- the disaggregation of changes in assets and liabilities should be based primarily on whether the change is due to subsequent remeasurements of the asset or liability to a current value (i.e., a valuation adjustment)
- disaggregated information should be presented in a reconciliation of the statement of cash flows to the statement of comprehensive income, in the notes to the financial statements
- the discussion paper should include the following formats for disaggregating changes in assets and liabilities (indicating that the last format is preferred):
 - a reconciliation of the statement of financial position
 - a statement of comprehensive income matrix
 - a reconciliation of the statement of cash flows to the statement of comprehensive income.

The Board discussed the classification of a single transaction that involves multiple assets or a combination of assets that would appear in more than one category under the proposed presentation format, but did not make any decisions.

Post-employment Benefits

The Board tentatively decided the following in respect of its post-employment benefits project:

- Unvested benefits resulting from defined return promises give rise to a liability.
- The contribution component of a defined return promise should be allocated to periods of service in line with the benefit formula.
- The benefits arising from the promised return component of a defined return promise should be recognised in the period in which the related contribution is allocated.
- The Board will not address in phase 1 whether expected increases in salary are relevant to assessing whether a benefit formula allocates a materially higher level of benefit to later years.

The Board reaffirmed its tentative decision at a previous meeting that for defined contribution promises the liability for unpaid contributions should be measured as the sum of the unpaid contributions. The Board instructed the staff to further develop examples that illustrate how the liability for unpaid contributions for a defined return promise should reflect the time value of money.

The Board tentatively concluded that if a benefit promise includes a promised return linked to an index, then it should be classified as a defined return promise.

The Board tentatively decided that for a defined return promise the change in the liability should be disaggregated between the service cost and the fair value gain / loss. The service costs would represent the initial recognition of the liability plus the initial fair value of the promised return, and the fair value gain / loss would represent the amount arising from the subsequent remeasurement of the liability.

Conceptual Framework

The Board continued redeliberating the Discussion Paper (DP) *Preliminary Views on an Improved Conceptual*

Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information, and tentatively decided in relation to Chapter 1 that:

- the objective of financial reporting pertains to financial reporting as a whole, and not just to financial statements
- specific decisions on the scope of financial reporting will be made in conjunction with phase E of the conceptual framework project *Presentation and Disclosure, Including Financial Reporting Boundaries*
- the ED will describe in general terms what financial reporting encompasses (the specific scope of financial reporting is planned to be addressed in a later phase)
- existing and potential investors, and creditors, are included in the primary user group
- potential users of financial reporting include government and regulatory bodies.

With respect to Chapter 2, the Board tentatively decided to remove timeliness as a component of relevance, and to describe it as an enhancing qualitative characteristic.

Short-term Convergence: Joint Ventures

The Board discussed the joint venture project, and tentatively decided:

- to add disclosure requirements to IAS 31 *Interests in Joint Ventures* for interests in joint ventures accounted for using the equity method, including:
 - the financial statement reporting date of the joint venture, when it differs from that of the venturer, and the reason for the difference
 - any restrictions on the ability of the joint venture to transfer funds to the venturer

- the unrecognised share of losses of a venturer in a joint venture when the venturer has discontinued recognition of its share of losses.
- that a venturer should present separately its share of:
 - profit or loss
 - other comprehensive income
 - any discontinued operations of joint ventures.
- that the consensus of SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* should be included in IAS 31
- that entities would apply the proposed amendments to IAS 31 retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- to delete certain disclosure requirements in IAS 28 *Investments in Associates* that relate to associates that are not accounted for using the equity method.

IFRS 1 Amendments

The Board tentatively decided to consider an amendment to IAS 27 based on the responses received to the IFRS 1 proposed amendments on the cost of an investment in a subsidiary (i.e., allowing the use of deemed cost for an investment in a subsidiary on first-time adoption of IFRSs and proposing a simplified method of determining the pre-acquisition accumulated profits of a subsidiary).

Financial Instruments

The Board discussed certain cash flow hedge application issues presented by representatives from the European Banking Federation in December 2006, and whether clarifications to IAS 39 are necessary. The Board did not make any decisions.

In addition, the Board instructed the staff to prepare a ballot draft of proposed amendments to IAS 39, which clarify:

- risks that qualify for designation as hedged risks
- situations in which an entity may designate a portion of the cash flows of a financial instrument as a hedged item.

Annual Improvements

As part of its forthcoming annual improvements ED the Board decided to propose amending:

- IAS 38 *Intangible Assets* to clarify that an entity should recognise an expense for advertising or promotional activities provided in exchange for goods or services when the benefit of the goods or services are available to the entity; the Board proposed in May 2007 to recognise the expense when the goods or services are delivered.
- IAS 16 *Property, Plant and Equipment* to reflect that if an entity routinely sells property, plant and equipment that it has held for rental, then such assets should be transferred to inventory at their carrying amount when they are no longer rented and are held for sale; proceeds from the sale of such assets should be recognised as revenue
- IAS 1 *Presentation of Financial Statements* to clarify the criteria used in determining the classification of derivatives as current or non-current
- IAS 39 to reflect the view that meeting or ceasing to meet the criteria included in the fair value through profit or loss definition does not, in certain circumstances, result in a reclassification
- IAS 39 to clarify that, when both are applicable, the requirement in paragraph 92, which results in a recalculated effective interest rate for hedge adjustments made to a hedged item, is applied before the requirement in paragraph AG8, which provides that the original effective interest rate is used to calculate the carrying amount of

a financial instrument that has revisions to estimates of payments or receipts

- IAS 39 to remove the suggestion that a prepayment option in a host debt contract is not closely related unless the option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument
- IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* to be consistent with IAS 39 and require interest to be imputed for below-market loans received from governments
- IAS 18 *Revenue* to align the definition of transaction costs with that in IAS 39
- IAS 41 *Agriculture* to remove the requirement that the market-determined discount rate should be a pre-tax rate
- IAS 39 and IAS 41 for minor wording improvements to clarify why financial guarantee contracts held by an entity are outside the

scope of IAS 39 and to amend the examples of agricultural produce, respectively.

Extractive Activities

The Board conducted its fourth educational session on its extractive activities research project. Representatives from the Society of Petroleum Engineers Oil and Gas Reserves Committee provided an update on a joint project with the Committee for Mineral Reserves International Reporting Standards that addresses the convergence of the petroleum and minerals definitions and classification systems.

In addition, the extractive activities project team provided an update on its research activities.

IFRIC – Approval of Interpretations

The Board approved for issue:

- IFRIC 14 – *IAS 19 – The Limit on a Defined Benefit Asset, Minimum*

Funding Requirements and their Interaction

- IFRIC 13 *Customer Loyalty Programmes*.

Technical Plan

The Board discussed its updated technical plan and project timetables, which are available on the IASB's Web site.

IASB Observer Notes

KPMG International Financial Reporting Group has arranged to make available to KPMG member firms' clients and contacts copies of the IASB Observer, a publication of European Research Associates Limited. The IASB Observer provides timely, detailed reporting of IASB meetings. Please talk to your usual local KPMG contact to receive this publication.

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