November 2009

IASB Update

From the International Accounting Standards Board

This IASB *Update* is a staff summary of the tentative decisions reached by the Board at a public meeting. As a project progresses, the Board can, and sometimes does, modify its earlier tentative decisions. Tentative decisions do not change existing requirements until those decisions are incorporated in a new or amended standard.

The International Accounting Standards Board met in London on 16 - 20 November 2009, when it discussed:

Other information

Contact us

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Tel: +44 (0)20 7246 6410

Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org
Website: www.iasb.org

Emissions Trading Schemes

The boards discussed the accounting for emissions cap and trade schemes. The meeting focused on schemes with voluntary participation (voluntary schemes), which involve contracts between knowledgeable and willing parties.

The boards discussed the application to a voluntary scheme of the definitions of an asset and a liability in the FASB Concept Statements and in the IASB Framework. The boards focussed their discussion on two views as to when liabilities arise in such a scheme:

- View 1 is that an entity's actual emissions are the obligating event in a voluntary scheme. An entity does not incur a present obligation, and hence a liability, until it has emitted. Until emissions have occurred, the entity can take action that enables it to avoid delivering allowances.
- View 2 is that entering into the membership contract is the event that creates a liability (the obligating event). By signing the membership contract, the obligation to pay allowances is unconditional.

The staff did not ask the boards to make any decisions at this meeting, but did seek advice as to which view had the stronger initial support. Both boards indicated a preference for view 2.

Next steps

The boards will discuss accounting models for emissions trading schemes (both voluntary and statutory) at a meeting in the first quarter of 2010.

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IFRIC Interpretation 19 ***Extinguishing Financial Liabilities with Equity Instruments***

The Board approved IFRIC Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments*, noting that the IFRIC voted for and confirmed the consensus, subject to its final review of drafting changes, at its November 2009 meeting.

IFRIC 19 provides guidance on the application of IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 32 *Financial Instruments: Presentation*, when an entity issues its own equity instruments to extinguish all or part of a financial liability.

In approving IFRIC 19, the Board:

- Agreed with IFRIC's conclusion that the Interpretation does not need to be re-exposed.
- Decided that an entity shall apply IFRIC 19 for annual periods beginning on or after 1 April 2010 with earlier application permitted. Retrospective application is required only from the beginning of the earliest comparative period presented.
- Approved an amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* as part of its approval of IFRIC 19.

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IFRIC Update

The Director of Implementation Activities reported on the IFRIC's meeting on 5 and 6 November 2009. Details of the meeting were published in IFRIC Update, available here.

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Income taxes

The Board discussed the scope of the income tax project. The Board instructed the staff to bring back proposals on which issues should be addressed in a limited scope project to amend IAS 12.

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Insurance contracts

Participating insurance contracts

The boards discussed participating features in insurance contracts. Staff presented two views on how to deal with such contracts:

View 1: All cash flows that arise from a participating feature should be included in the measurement of the insurance liability on an expected present value basis. The participating feature is not considered separately for recognition, classification and measurement, but rather as part of the whole contract.

View 2: The cash flows expected to arise from a participating feature are analysed to determine whether those flows are required (eg by the contract or by a statute) or are discretionary. Required cash flows (if there are any) will be included in the measurement of the insurance liability. Discretionary cash flows will be recognised when the entity has an obligation to make payments.

The IASB tentatively decided on view 1 and the FASB tentatively decided on view 2.

Next steps

The boards will continue their discussion of this project at the joint board meeting in December.

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Leases

Lessee accounting

The boards discussed:

- Initial and subsequent measurement of the lessee's obligation to pay rentals and right-of-use asset
- Leases with options.

The boards tentatively decided to specify the required accounting for a lessee's obligation to pay rentals and right-of-use asset as follows:

- Initial measurement of the lessee's obligation to pay rentals would be at the present value of the lease payments discounted using the lessee's incremental borrowing rate. The boards noted that the interest rate implicit in the lease will often equal the incremental borrowing rate. Consequently, they tentatively decided that the interest rate implicit in the lease can be used if it can be readily determined. The staff will develop a definition of the interest rate implicit in the lease that would be consistent with a right-of-use model.
- Subsequent measurement of the lessee's obligation to pay rentals would be at amortised cost using the effective interest method; the obligation arising in a simple lease would not be revised for any changes in the lessee's incremental borrowing rate. The boards will consider, at a future meeting, whether the incremental borrowing rate would be reassessed when there are changes in the expected lease term. Subsequent measurement of the obligation at fair value is not permitted.
- Initial measurement of the lessee's right-of-use asset would be at cost, where cost is the present value of the lease payments plus any initial direct costs incurred by the lessee. The staff will assess whether the definition of initial direct costs is consistent between US GAAP and IFRSs.
- Subsequent measurement of the lessee's right-of-use asset would be at amortised cost and would be described as amortisation rather than as rental expense.
- The lessee's right-of-use asset would be considered for impairment by referring to existing

applicable standards for impairment. A lessee preparing financial statements in accordance with IFRS would follow IAS 36 *Impairment of Assets*. A lessee applying US GAAP would follow Topic 350, Intangibles - Goodwill and Other of Accounting Standards Codification.
- IFRS preparers would be permitted to revalue their right-of-use assets using the revaluation model in IAS 38 *Intangible Assets*; US GAAP preparers would not be permitted to revalue their right-of-use assets unless required to do so to recognise an impairment loss.

The boards discussed how the lessee would account for lease contracts that grant the lessee the right to extend or terminate the lease. The boards tentatively decided that:

- Uncertainty about the lease term would be addressed through recognition - that is, one of the possible lease terms is selected and the accounting is based on that term.
- The recognised lease term would be the longest possible lease term that is more likely than not to occur.
- In determining the lease term, the lessee would consider all relevant factors.
- Options to renew a lease that are priced at market value at the date of renewal would be considered when determining the lease term.
- The lease term would be reassessed at each reporting date. Detailed examination of every lease would not be required unless there is a change in facts or circumstances that indicate that the lease term may need to be revised.
- Any change to the obligation to pay rentals resulting from a reassessment of the lease term would be recorded as an adjustment to the right-of-use asset.

Lessor accounting

The boards discussed:

- Initial and subsequent measurement of the lessor's receivable and performance obligation
- Leases with options.

The boards tentatively decided to specify the required accounting for a lessor's receivable and performance obligation as follows:

- Initial measurement of the lessor's receivable would be at the present value of the lease payments discounted using the interest rate implicit in the lease plus any initial direct costs incurred by the lessor.
- Subsequent measurement of the lessor's receivable would be at amortised cost using the effective interest method.
- Initial measurement of the lessor's performance obligation would be at the transaction price (ie the customer consideration, which will be measured at the present value of the lease payments discounted using the interest rate implicit in the lease).
- Subsequent measurement of the lessor's performance obligation would reflect decreases in the obligation to permit the lessee to use the leased item over the lease term.

The boards discussed how the lessor should account for lease contracts that grant the lessee the right to extend or terminate the lease. The boards tentatively decided that:

- The accounting by lessors for those options would be symmetrical with the accounting by lessees for those options; however, the boards noted that the objective of symmetry might not result in the same measurement of lease payments by the lessee and the lessor.
- A lessor's receivable and performance obligation should be recognised based on the lease payments that will be received over the lease term. The recognised leased term would be the longest possible lease term that is more likely than not to occur.
- The lease term would be reassessed at each reporting date. Detailed examination of every lease would not be required unless there is a change in facts or circumstances that would indicate that the lease term may need to be revised.
- Any change to the lease receivable resulting from a reassessment of the lease term would be recorded as an adjustment to the performance obligation.

In December, the boards will continue discussing lessee and lessor accounting issues including how to account for leases that include contingent rental arrangements.

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Liabilities

The Board considered the proposed measurement requirements for liabilities within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

Onerous contracts.

The Board decided tentatively to make a limited exception to the proposed measurement requirements. The exception would be restricted to onerous contracts arising from transactions within the scope of IAS 18 *Revenue* and IFRS 4 *Insurance Contracts*. It would require entities to measure the onerous contract liability by reference to the expected costs of supplying the goods or services, rather than the amounts that the entity would pay a contractor to supply them on its behalf.

The purpose of the exception would be to postpone any change in practice for measuring those contracts, pending completion of the Board's revenue and insurance projects. When the Board issues its new revenue and insurance standards, it will either confirm the exception (possibly taking the contracts out of the scope of IAS 37) or delete it (bringing the measurement requirements for onerous sales and/or insurance contracts into line with the measurement of other liabilities in the scope of IAS 37).

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Post-employment benefits

The Board discussed two issues in the post-employment benefits project: presentation and a disclosure issue.

Presentation

The Board decided to propose that pension remeasurements should be presented in the other comprehensive income section of the statement of comprehensive income.

The Board also asked the staff to bring to a future meeting papers on two aspects of the definition of remeasurement: changes in estimates of the service cost and interest income.

Disclosures

The Board reaffirmed the decision in its July meeting to require the disclosure of the defined benefit obligation excluding projected salary increases in the forthcoming exposure draft.

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Proposed amendments to IFRS 1

The Board was advised that the transition provisions within the *Improving Disclosures about Financial Instruments* (Amendments to IFRS 7 *Financial Instruments: Disclosures*) issued in March 2009 provide relief in the first year of application from providing comparative information for the disclosures required by the amendment. The Board noted that a first-time adopter applying the provisions of IFRS 1 *First-time adoption of International Reporting Financial Standards* would not currently receive the same relief from providing comparative information.

The Board reiterated its basis for conclusions on the Amendments to IFRS 7 that, although the effective date of IFRSs and amendments to IFRSs is usually 6-18 months after issue, the urgent need for enhanced disclosures about financial instruments demanded earlier application. Given the timing of issue of the amendment and the likely use of hindsight required for the disclosures, the Board permitted the first year of application of the amendment to exclude comparative period disclosures required by the Amendment to IFRS 7.

The Board acknowledged that the same justifications from full retrospective application should apply equally to current IFRS preparers and first-time adopters. Consequently, the Board decided to propose an amendment to Appendix E to IFRS 1. The proposed amendment provides relief from the requirement to provide comparative period disclosures required by IFRS 7 to the extent the first IFRS reporting period starts earlier than 1 January 2010.

The Board decided to publish an exposure draft of this proposal in November with a 30-day comment period. The Board expects to finalise the amendment at its January 2010 meeting.

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Revenue Recognition

The boards discussed three topics:

- licensing contracts
- subsequent measurement of performance obligations
- contract costs.

Licensing contracts

The boards discussed the nature of the performance obligations in a contract in which an entity grants a customer the right to use, but not own, intellectual property of the entity, eg a software licence.

The boards decided tentatively that:

- if a customer obtains control of the entire licensed intellectual property, the contract should be considered a sale, rather than a license or lease, of the intellectual property. That would be the case, for instance, if an entity grants a customer the exclusive right to use its intellectual property for the duration of its economic life.
- if a customer does not obtain control of the entire licensed intellectual property and the entity has promised to grant an exclusive license, the promised asset is similar to the asset that a lessor promises in a lease. Consequently, consistently with the Boards' tentative decisions in the Leases project, the entity has a series of performance obligations. It satisfies those obligations over time as it permits the customer to use its intellectual property.
- in all other cases, the promised asset is the licence. The promise to grant that licence is a single performance obligation. The entity satisfies that obligation when it enables the customer to use the licence and benefit from it. If there are other performance obligations in the contract, an entity should consider whether the performance obligation for the licence is a separate contract

segment or if it should be combined with those other performance obligations.

Subsequent measurement of performance obligations

The boards discussed how performance obligations should be measured after contract inception. The boards tentatively confirmed that performance obligations within the scope of the revenue recognition standard should be remeasured after contract inception only when they are onerous.

For the onerous test, the boards decided tentatively that:

- an entity should conduct the onerous test at the level of contract segments.
- an entity should compare the amount of the transaction price allocated to the remaining performance obligations in a segment with the expected costs to satisfy those performance obligations (rather than the current value of the goods and services underlying those performance obligations).
- if the expected costs to satisfy the remaining performance obligations in a segment exceed the amount of the transaction price allocated to those performance obligations, an entity should recognise a liability and a corresponding contract loss. The entity should measure the liability at the expected costs to satisfy the remaining performance obligations in that contract segment less the transaction price allocated to those performance obligations.
- at each subsequent financial statement date, an entity should update the measurement of the liability for the onerous segment.
- for the onerous test, costs are the direct costs, ie all costs that relate directly to the specific contract or that were incurred only because the entity entered into the contract.

Contract costs

The boards discussed whether specific guidance on contract costs is needed in the revenue recognition standard.

The IASB decided tentatively not to develop guidance for accounting for contract costs. An entity would account for those costs in accordance with other standards as applicable, eg IAS 2 *Inventory*.

The FASB directed the staff to analyse further the effects of withdrawing guidance relating to costs from Accounting Standards Codification Topic 605 *Revenue*.

Next steps

In November and December, the staff will test the proposed revenue recognition model by conducting a series of workshops in London, Tokyo, Melbourne and Norwalk with preparers of financial statements from various industries.

At the December meeting, the boards plan to consider warranties, rights of return and the use of estimates of uncertain consideration.

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SAC Update

Paul Cherry, the Chairman of the Standards Advisory Council of the International Accounting Standards Board, gave the Board an update via video from Toronto of the SAC meeting held in London in the previous week. A recording of the meeting and a staff summary will be available on the IASB website by the end of November.

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Future Board meetings

The Board will meet in public session on the following dates in 2009. Meetings take place in London, UK, unless otherwise noted.

14-18 December

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Past issues of IASB *Update*

Click here for archived copies of past issues of IASB ***Update*** on the IASB website.

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Forthcoming comment deadlines

The list below includes all forthcoming deadlines up to the December 2009 Board meeting. For a full list of comment deadlines, visit the Open to Comment section of the IASB website.

- 24 November 2009 - Improvements to IFRSs
- 27 November 2009 - IFRS for SMEs Taxonomy
- 30 November 2009 - Constitution Review - Proposals for enhanced public accountability

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