IFRS in Brief

May 2006, **Issue 24**

This issue of *IFRS in Brief* covers the April 2006 meeting of the International Accounting Standards Board (IASB) and the April 2006 joint meeting of the IASB and the U.S. Financial Accounting Standards Board (FASB).

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

Summary

At the IASB meeting, the Board:

- discussed the conceptual framework project and made several tentative decisions with respect to the concept of control
- made several tentative decisions on phase II of the insurance project
- discussed revenue recognition, hedge accounting and the forthcoming exposure draft (ED) on financial instruments puttable at fair value, and held educational sessions on consolidation and classification as liability or equity.

At the joint meeting of the IASB and the FASB, the Boards:

- re-deliberated several proposals included in the EDs resulting from phase II of the business combinations project
- decided to explore a revenue recognition model whereby revenue would be recognised proportionately as performance occurs, if the customer must accept performance to date
- discussed several issues relating to the conceptual framework project.

IASB Meeting

Conceptual Framework

The Board discussed several issues regarding the concept of control over an entity and tentatively agreed that:

- control should be defined at a conceptual level and not at the individual standard level
- the definition of control should include both power and benefit elements, which is consistent with the working definition of control being used by the Board: *"the ability to direct the strategic financing and operating policies of an entity so as to access benefits flowing from the entity and increase, maintain or protect the amount of those benefits"*
- all facts and circumstances should be considered in assessing control
- "benefits" in the definition of control should refer to general rather than specific economic benefits, and should not be subject to a minimum amount of benefits.

AUDIT ■ TAX ■ ADVISORY

In preparing for the joint meeting (see below) the Board also discussed several issues relating to the definitions of assets and liabilities, distinguishing liabilities from equity and the project plan. No decisions were made in these areas.

Insurance Contracts

At previous meetings the Board explored a current value model of measuring insurance liabilities, which would be based on discounted expected future cash flows, and would include an explicit risk margin. At this meeting the Board tentatively decided:

- not to develop guidance on determining discount rates for contracts with maturity dates beyond those that can be observed in the market, or interest rates for currencies with a limited risk-free instrument market
- that current exit value (what the insurer would have to pay to transfer its obligations to another entity) would be preferred in determining the margin on an insurance contract
- that service (profit) margin should be included in the measurement of insurance liabilities, in addition to the risk margin
- that cash flows dependent upon the policyholder renewing their contract (customer relationship) should be measured as part of the insurance liability, rather than as a separate asset
- that unbundling of the deposit and service components of an insurance contract should not be required.

The Board also discussed the following issues, but made no decisions:

- whether risk margins should be determined for individual contracts or for a portfolio of contracts
- whether assets and obligations related to separate accounts (contracts in which insurance benefits are dependent upon a designated pool of assets managed similarly to a mutual fund) should be recognised on the insurer's balance sheet
- how to measure premiums that are based on an internal or external index or investment fund.

Other

The Board also:

- discussed several alternatives for revenue recognition models, but made no decisions
- discussed ways to simplify hedge accounting as required by IAS 39 *Financial Instruments: Recognition and Measurement,* but made no decisions
- discussed the costs and benefits of the proposed amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 1 *Presentation of Financial Statements* that would require certain financial instruments puttable at fair value to be classified as equity, and agreed to proceed with issuing the ED
- received an update on the timetable and the approach for completion of phase II of the business combinations project
- held educational sessions on consolidation, in particular on U.S. FASB Interpretation (FIN) 46R *Consolidation of Variable Interest Entities,* and the FASB's liabilities and equity project.

Joint Meeting of the IASB and the FASB

Business Combinations

The Boards discussed comments received on the EDs resulting from phase II of the business combinations project. The Boards:

- reaffirmed the proposal that acquisition costs be accounted for separately from the business combination
- decided that the FASB standard on business combinations should require a reconciliation of the carrying amount of equity attributable to controlling interests (parent interests) and equity attributable to non-controlling interests (minority interests) at the beginning and at the end of the period, which would converge with existing IFRSs
- decided that the IFRS should require disclosure of the effect of transactions with non-controlling interests on the equity attributable to controlling interests, which would converge with the FASB's ED
- decided that in addition to disclosure of the gain or loss recognised on remeasurement of a non-controlling equity investment remaining after losing control of a subsidiary, the IFRS should require disclosure of the income statement line item where this gain or loss is included, which would converge with the FASB's ED
- reaffirmed that income from continuing operations, discontinued operations and items of income or expense recognised directly in equity attributable to controlling interests should be disclosed, but amounts attributable to non-controlling interests need not be disclosed
- discussed how the revised definition of fair value[1] may impact the presumption that the best evidence of fair value of the acquiree is the consideration transferred in the business combination, but made no decisions in this area.

1 The working draft of the FASB's standard *Fair Value Measurement* dated 15 March 2006 defines fair value as *"the price that would be received for an asset or paid to transfer a liability in a transaction between market participants at the measurement date"*. In its previous meetings the IASB tentatively decided to propose adopting the FASB's definition.

Revenue Recognition

The Boards discussed two alternative models for revenue recognition: one focused on the customer's perspective, whereby revenue would be recognised when the entity's obligation to perform is extinguished and the customer obtains the right to benefit from the goods, services or other rights provided; and another focused on the entity's perspective, whereby revenue is recognised as production occurs. The Boards decided to explore a model whereby revenue would be recognised proportionately as performance occurs, if the customer must accept performance to date. Customer acceptance would be deemed to occur only when it gives the entity an unconditional right to receive payment for its performance to date.

Conceptual Framework

The Boards discussed a plan for deliberating phase C of the conceptual framework project (measurement), and agreed that the project would include the following milestones:

- defining and describing the properties of measurement bases
- evaluating measurement bases using the qualitative characteristics
- conceptual conclusions and practical applications.

The Boards agreed to have public consultations and to publish a due process document (discussion paper or ED) for each of the milestones.

The Boards also agreed to release a discussion paper for phase A of the conceptual framework project (objectives and qualitative characteristics) containing the preliminary views of the Boards.

In addition, the Boards discussed various issues related to the definitions of assets and liabilities, but made no decisions.

Other

The Boards also:

- discussed the process for creating, and the content of, the due process document (discussion paper or ED) on accounting for financial instruments
- discussed potentially adding to their agendas a joint project on accounting for leases.

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.

If you would like further information on any of the matters discussed in this issue of *IFRS in Brief*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.

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