

# IFRS in Brief

June 2006, **Issue 25**

This issue of *IFRS in Brief* covers the May 2006 meeting of the International Accounting Standards Board (IASB).

## Summary

At this meeting, the Board:

- re-deliberated proposals in the Exposure Draft (ED) of *Proposed Amendments to IFRS 3 Business Combinations*
- made several tentative decisions on phase II of the insurance project
- reviewed the draft ED of an *IFRS for Small and Medium-sized Entities* (SMEs)
- discussed the draft fair value measurement standard of the U.S. Financial Accounting Standards Board (FASB)
- re-deliberated proposals in the ED of *Proposed Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits*.

## Business Combinations

The Board continued re-deliberating proposals in the ED of *Proposed Amendments to IFRS 3* and discussed several proposed exceptions to the general principle that assets and liabilities acquired in a business combination should be measured at fair value. The Board:

- tentatively decided to propose amending IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to require the measurement of non-current assets (and disposal groups) meeting the definition of held for sale at the lower of their carrying amount and fair value, rather than fair value less costs to sell – this would avoid the need for an immediate write-down following a business combination for an amount equal to the costs to sell
- tentatively decided that rights and obligations related to an operating lease should be recognised on a net basis, resulting in an intangible asset if contract terms are favourable and a liability if contract terms are unfavourable
- reaffirmed the proposal in the ED that assets and liabilities related to post-employment benefit plans be measured in accordance with IAS 19 *Employee Benefits*, rather than at fair value.

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### Insurance Contracts

The Board continued discussing a model that would measure an insurance liability based on its exit value, i.e., the price that an entity would pay to transfer the obligation to another entity. The Board made the following tentative decisions:

- An insurance liability should be measured based on the price expected to be paid in a transfer that does not change the liability's credit characteristics, i.e., credit characteristics should be included in the measurement. An entity should disclose how credit characteristics affect the initial measurement of the liability and any significant changes in credit characteristics.
- Reinsurance assets and liabilities should be measured based on their exit values. The measurement of reinsurance assets should reflect expected losses from defaults and disputes.
- The recognition of gains and losses upon the purchase of reinsurance should not be restricted.
- Insurance contracts acquired in a portfolio transfer should be measured at their exit value; any difference between that value, and the consideration paid plus the fair value of any other assets received, should be recognised in profit or loss.

The Board also discussed universal life contracts, unit- or index-linked obligations, and salvage and subrogation rights. Discussions on these topics are expected to continue at future meetings.

### Small and Medium-sized Entities

The Board reviewed a draft ED of an *IFRS for SMEs* and made a number of decisions, including the following:

- Entities providing essential public services should be excluded from

the definition of publicly accountable entities.

- In accounting for transactions that are not addressed specifically by the *IFRS for SMEs*, SMEs should first consider analogous principles in the standard before considering the full text of IFRSs.
- Derivatives and financial assets with readily determinable fair values should be measured at fair value through profit or loss; and applicability of the fair value option should not be restricted.
- The *IFRS for SMEs* should include the same exceptions to the basic principles of accounting for deferred taxes as in IAS 12 *Income Taxes*.
- The *IFRS for SMEs* should include an option to expense all development costs as incurred.

### Fair Value Measurement

The Board discussed the FASB's draft standard *Fair Value Measurements*. The Board intends to publish the FASB's final standard as an ED, identifying any areas of disagreement between the IASB and the FASB. The Board made the following tentative decisions:

- Fair value measurement should be based on the exit price of an asset or liability, described in the FASB's draft standard 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."
- Fair value measurement should be based on the following hierarchy contained in the FASB's draft standard, from most to least reliable: (1) quoted market prices for an identical asset or liability; (2) observable inputs other than quoted market prices; and (3) unobservable inputs, such as models or projections. The Board was of the opinion that more guidance was necessary to distinguish between (2) and (3) above.

- Guidance for determining the unit of account should not be provided in the fair value measurement standard, but rather should be addressed in each individual standard requiring fair value measurement. The Board agreed that entities should not be allowed to recognise a "blockage" factor (i.e., a discount for the size of holding) in any level of the hierarchy noted above. Currently the draft standard precludes recognition of a blockage factor only for "quoted market prices for an identical asset or liability".
- Consistent with the FASB's draft standard, exit price should be based on the principal market (market with the highest activity level for similar transactions) or, if there is no principal market, on the most advantageous market (market where the entity can complete the transaction on the most favourable terms).
- Consistent with the FASB's draft standard, fair value on initial recognition should not be presumed to be the transaction (entry) price, as this may be different from an exit price in certain circumstances.
- The Board expressed concern over an option in the FASB's draft standard to use a pricing convention, such as mid-market pricing, for fair value measurements based on bid and ask prices. The Board agreed that measurement should be based on a price within the bid-ask spread at which the transaction would have taken place at the measurement date.
- Consistent with the FASB's draft standard, fair value measurement should exclude transaction costs, but should consider the attributes of the asset or liability in its current location and condition (e.g., taking into account transportation costs).

### Provisions – Amendments to IAS 37

The Board started re-deliberating the recognition principles proposed in the ED of *Proposed Amendments to IAS 37 and IAS 19*. The Board:

- reaffirmed that the definition of a liability in the *Framework*, i.e., an obligation that is “*expected to result in an outflow... of resources embodying economic benefits*,” is not intended to require a certain level of certainty about the outflow in order for a liability to be recognised
- decided that the final standard should include additional guidance on identifying stand-ready obligations and on recognising a liability if existence of a present obligation is uncertain.

### Other

The Board also:

- held an educational session on service concession arrangements
- discussed the May 2006 meeting of the International Financial Reporting Interpretations Committee
- discussed adding to its agenda projects on employee benefits and related party disclosures
- discussed the determination of the cost of a subsidiary in the parent’s separate financial statements when it adopts IFRSs, but reached no decisions.

### IASB Observer Notes

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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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