

IFRS in Brief

May 2005, **Issue 13**

This issue of *IFRS in Brief* covers the April 2005 meeting of the International Accounting Standards Board (IASB) and the April 2005 joint meeting of the IASB and U.S. Financial Accounting Standards Board (FASB).

Topics discussed by the IASB at its April 2005 meeting included:

- The fair value option
- Financial guarantees
- Proposed amendment to IFRS 6 *Exploration for and Evaluation of Mineral Resources*
- Income taxes.

Topics discussed by the IASB and FASB at their joint meeting included:

- Performance reporting
- Conceptual framework
- Financial instruments.

IASB Meeting

The Fair Value Option

At its March 2005 meeting the Board finalised amendments that will restrict use of the current unrestricted option to classify a financial asset or liability as measured at fair value through profit or loss.

At this meeting the IASB focused on transition requirements. The Board decided to permit both current users

of IFRSs as well as first-time adopters to designate items for fair value measurement at the date of adoption of the amendment, if the items satisfy the modified criteria for that designation.

Transition Requirements and Effective Date

The Board reconfirmed its decision that adoption of the amendment should be mandatory for annual periods beginning on or after 1 January 2006, with earlier application encouraged.

The Board changed its previous tentative decision and decided to permit the designation, at the date of adoption, of any financial assets or liabilities that qualify under the amended fair value option, if the amendment is adopted in an accounting period that begins before the proposed mandatory adoption date of the amendment. Unlike the Board's previous tentative decision, this includes entities that have adopted the unrestricted version of the fair value option.

The Board also decided:

- that, at the date of transition, financial assets or financial liabilities that were designated in hedge accounting relationships in the comparative period should be de-designated from those hedge accounting relationships if they are

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designated as at fair value through profit or loss

- to require many early adopters to restate comparatives for retroactive designation of qualifying assets and liabilities
- to permit early adopters of the amendment a free choice over designation of financial assets or financial liabilities arising on or before the beginning of the financial year in which the amendment was adopted. This free choice for early adopters also would apply to items recognised during the year of adoption up to three months after the date of publication of the amendment. This would permit a calendar year-end entity to designate any qualifying item recognised after 1 January 2005.

Restatement of Comparatives

The Board changed its previous decision and decided to require the restatement of comparatives provided that relevant assets or liabilities would have qualified for designation at fair value through profit or loss under the amended fair value option at the beginning of the comparative period or, if acquired after the beginning of the comparative period, at the date of initial recognition.

Financial Guarantees

The Board considered the staff's analysis of a possible modified approach. Under this modified approach IAS 39 *Financial Instruments: Recognition and Measurement* would apply to contracts that meet the definition of a financial guarantee contract unless an entity historically had been treating such contracts as insurance contracts and had disclosed that it was doing so. In that case an entity would be permitted to apply IFRS 4 *Insurance Contracts* to financial guarantees. The Board decided to pursue this

approach and asked the staff to draft the final text for ballot. The final standard is expected in July 2005.

Proposed Amendment to IFRS 6 *Exploration for and Evaluation of Mineral Resources and Consequential Amendment to IFRS 1 First-time Adoption of International Financial Reporting Standards*

Currently IFRS 1 provides an exemption for first-time adopters of IFRSs that adopt IFRS 6 before 1 January 2006. These entities are exempted from the requirement to present the comparative disclosures under IFRS 6 in their first IFRS financial statements. The Board decided to propose an amendment to IFRS 1 to clarify that its intention was to provide a relief not only from *presenting* the comparative disclosures under IFRS 6 but also from *applying* the recognition and measurement requirements of IFRS 6 to the comparative period. The exposure draft of the proposed amendment has been posted for comment on the IASB's Web site. The deadline for comments is 3 June 2005.

Income Taxes – Convergence with U.S. GAAP

Intraperiod Tax Allocation (Backwards Tracing)

Unlike SFAS 109 *Accounting for Income Taxes*, IAS 12 *Income Taxes* does not include detailed guidance on allocation of income tax expense or benefit for the year among the components of comprehensive income and equity. The IASB decided to converge with U.S. GAAP and include SFAS 109 guidance on intraperiod tax allocation in IAS 12. Therefore, it appears that entities reporting under IFRSs would no longer be required or permitted to report subsequent changes in tax directly in equity for tax amounts recognised initially in equity. The

Board noted that it would revisit this issue in light of the outcome of the performance reporting project.

Distributed versus undistributed rate
The IASB was informed that the FASB had decided to converge with the IASB and require the use of the tax rate applicable to undistributed profits, rather than distributed profits as currently required by SFAS 109, for measuring tax assets and liabilities arising from temporary differences.

Enacted Versus Substantively Enacted Rate

The IASB was informed that the FASB agreed to require the use of the rates and laws that are "enacted or substantively enacted," rather than "enacted" as currently required by SFAS 109 for measuring current and deferred taxes. However, the FASB also decided to explain in its exposure draft that, under the U.S. legislative process, "substantive enactment" occurs when the tax laws are enacted. The IASB agreed to include this clarification on when "substantive enactment" occurs in U.S. tax jurisdictions in its amendment to IAS 12.

Educational Sessions

The Board held educational sessions on:

- methods used for evaluation of mineral and oil and gas reserves
- developments in the Australian insurance sector
- developments in the Canadian non-life insurance sector.

No decisions were made.

Joint IASB and FASB Meeting Performance Reporting

In April 2004 the Boards agreed to add a joint project on performance reporting to their agendas. The project will be split into a short-term phase focused on convergence

issues (segment A) and a long-term phase aimed at developing standards for presentation of information on the face of the required financial statements (segment B).

Segment A

At the April 2005 meeting the Boards agreed:

- to require a single statement of comprehensive income with a total for non-owners' changes in financial position and a required subtotal for net profit or loss
- that each primary financial statement within the full set of financial statements should be shown with equal prominence (i.e., cannot be presented as part of the notes)
- to require at least two annual periods (i.e., current annual period and prior annual period) to be included in a full set of financial statements
- not to address in this part of the project the issues related to the contents of notes to the financial statements and the contents of interim financial statements
- to move directly to issuing a joint exposure draft without issuing a discussion paper and to explain the rationale for the changes proposed through communication documents and round-table meetings
- to amend the existing guidance by amending IAS 1 *Presentation of Financial Statements* and issuing a new FASB statement similar to IAS 1
- that a full set of financial statements should comprise a beginning- and end-of-period statement of financial position, a statement of earnings and

comprehensive income, a statement of changes in equity and a statement of cash flows. As a result one more balance sheet will be required than is needed now.

Segment B

At the April 2005 meeting the Boards agreed:

- to develop a single standard that would include the outcomes of both segments of the project and would apply broadly to all for-profit entities. The Boards will consider subsequently the application of the standard to financial institutions
- to form a subgroup, comprising representatives from financial institutions, to help the Boards identify and understand the issues related to reporting by financial institutions
- to work on segment A and segment B sequentially rather than simultaneously
- to include in segment B issues related to the statement of cash flows (direct or indirect method).

Conceptual Framework

The IASB and FASB discussed a number of issues related to the objectives of financial reporting.

Financial Instruments

The Boards discussed possible ways forward for future projects in the area of financial instrument accounting. The staff presented four alternative approaches to improving financial instrument accounting:

- a move to full fair value accounting for all financial instruments

- improving the mixed attribute model for measuring financial instruments by using a model that is a comprehensive measurement framework but not a full fair value model for all financial instruments
- identifying separate areas of financial instruments accounting, such as derecognition, and improving and simplifying the requirements in these areas
- simplifying the existing standards and removing reconciling items.

The Boards expressed strong support for the full fair value approach but noted that it might be necessary to move there gradually, and that they would consult with the Financial Instruments Working Group about this. The Boards also identified derecognition as a key area that they might work on as a separate project.

IASB Observer Notes

KPMG has arranged to make available to our 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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