

IFRS in Brief

November 2005, **Issue 18**

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

Summary

The IASB October 2005 meeting was largely devoted to preparation for the joint meeting of the IASB and FASB. In addition, the Board:

- discussed decisions taken at the International Financial Reporting Interpretations Committee's (IFRIC's) August and September 2005 meetings
- decided not to propose a technical correction to IFRS 1 *First-time Adoption of International Financial Reporting Standards* related to accounting for a deferred tax adjustment by a first-time adopter who elected not to restate past business combinations
- decided to propose amending IAS 23 *Borrowing Costs* to remove the option to expense borrowing costs incurred in construction or development of qualifying assets
- discussed issues relating to the definition of control of one entity over another, including de-facto control, and 'autopilot' arrangements

- discussed a pre-ballot draft of the Proposed Amendments to IAS 1 *Presentation of Financial Statements*.

At the joint meeting of the IASB and FASB, the Boards discussed several on-going joint projects. No major decisions were made. Issues considered by the Boards included:

- financial performance reporting
- revenue recognition
- accounting for income taxes
- financial instruments
- common conceptual framework.

IASB Meeting

IFRIC Update – Accounting for Minimum Funding Requirements under IAS 19 *Employee Benefits*

The Board's discussion of IFRIC activities focused on guidance published in the September 2005 issue of *IFRIC Update* concerning accounting for pension plan surplus when a minimum funding requirement has been imposed. The IFRIC concluded that if a surplus in the plan would be refunded to the entity upon the plan's settlement or at the end of the plan's life, then it should be recognised as an asset, net of any associated settlement costs. *IFRIC Update* also discusses how an entity may recognise an asset available as a reduction in future contributions, if the plan surplus cannot be refunded. The Board discussed the conclusions

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

reached by the IFRIC. No decisions were made.

Technical Correction to IFRS 1

The Board discussed a possible technical correction to IFRS 1, which would allow a deferred tax adjustment associated with intangible assets recognised under the Previous GAAP to be recorded by increasing goodwill. Currently, IFRS 1 requires such a deferred tax adjustment to be recognised through opening retained earnings. The Board acknowledged that IFRS 1 exemptions would inevitably lead to anomalies, and decided not to propose a technical correction.

Borrowing Costs

The Board considered various convergence issues related to accounting for borrowing costs. The Board decided to propose eliminating the option currently available in IAS 23 to expense borrowing costs associated with the construction or development of the qualifying asset. The Board considered other differences between IAS 23 and the U.S. Standard SFAS 34 *Capitalisation of Interest Cost*, including the calculation of borrowing costs, and definition of qualifying assets. The Board plans to continue discussing these issues in future meetings.

Control, including Special Purpose Entities

The Board confirmed its view that under IAS 27 *Consolidated and Separate Financial Statements*, consolidation can be based on de-facto control, and does not necessarily require the entity to hold a majority of voting rights.

The Board also discussed whether control may exist when determination of operating and financing policies of an entity had been set on autopilot. The Board reached no decisions on the issue and plans to continue discussion in its future meetings.

Performance Reporting

The Board discussed a number of issues relating to a pre-ballot draft of the Proposed Amendments to IAS 1. The Board decided:

- to refer to non-owner changes in equity as 'recognised income and expense' rather than 'comprehensive income'
- to refer to the four primary statements as 'statement of financial position', 'statement of changes in equity', 'statement of recognised income and expense', and 'statement of cash flows'
- to permit the use of the titles for primary financial statements other than those used in the Standard
- to use the term 'profit or loss' for a mandatory subtotal within the statement of recognised income and expense
- not to require presentation of each reserve balance, such as revaluation surplus, on the face of the primary financial statements
- to require disclosure of tax effects associated with each component of recognised income and expense not included in profit or loss
- to allow presentation of either a single statement of recognised income and expense, or two statements, provided that this would converge with the FASB
- that the effective date of the amendments will be for periods beginning on or after 1 January 2007, with earlier application encouraged
- to allow a comment period of 120 days for the exposure draft of the proposed amendments.

Other

The Board also:

- reviewed the timeline for the business combinations project, noting that issuing the final revised standard on business

combinations prior to the end of 2006 would be challenging

- held educational sessions on service concessions and insurance contracts
- reviewed staff proposals on the conceptual framework, revenue recognition, and financial instruments, in preparation for the joint meeting with the FASB.

Joint Meeting of the IASB and FASB

Comprehensive Financial Reporting Model

The CFA Institute presented to the Boards its proposals for a comprehensive financial reporting model, which was published in October 2005. The proposals include a view that financial reporting should be focused on the needs of the residual common shareholder in the company. The CFA Institute suggested changes to financial reporting that would aim to improve understandability, including enhanced disclosure of how significant items were measured. The CFA Institute was also supportive of fair value as a measurement attribute, and argued that relevance of information was more important than its reliability.

Performance Reporting – Financing Transactions

The Boards decided that a financing category should be presented within the statement of recognised income and expense. The Boards agreed to develop a definition of this category before defining any other category, and concluded that this definition should be consistent across non-financial entities.

Revenue Recognition

The Boards continued their discussion of the revenue recognition method that would be based on changes in assets and liabilities that are created by contracts with customers. In previous deliberations, the Boards concluded

that performance obligations generally would be measured based on the allocated customer consideration amount, which is defined as an amount at which a related component is, or is capable of, being sold. At this meeting, the Boards:

- clarified that performance obligations would include obligations to deliver 'other rights', as well as goods and services
- discussed potential measurement methods that may be used to determine the allocated customer consideration amount.

The Boards had divergent views on how to measure unconditional stand-ready obligations, such as warranties. The FASB concluded that such obligations should be measured at the allocated customer consideration amount, while the IASB concluded that they should be measured at fair value, as an exception to the general measurement principle. The Boards decided to prepare a discussion paper outlining both views and seek constituents' input on the issue.

The Boards also discussed a number of examples illustrating application of the revenue recognition method, including situations when some customers' rights are not expected to be exercised, accounting for non-refundable up-front fees (e.g., loan origination fees), and accounting for statutorily-imposed warranties.

Income Taxes

The Boards discussed accounting for uncertain tax positions. The Boards have previously expressed differing views on whether a probability recognition threshold should be

applied to tax deductions. The Boards agreed to seek a converged solution on this issue, following the FASB's analysis of the comments on its draft Interpretation of FASB Statement 109 *Accounting for Income Taxes*, and the IASB's development of the exposure draft on income taxes.

The Boards previously decided that an undistributed tax rate should be used to measure deferred tax on undistributed earnings of subsidiaries. At this meeting, the Boards discussed the effect of this proposal on entities that consider themselves tax exempt, for example, real estate investment trusts (REITs), other investment trusts, and cooperatives. The Boards asked the staff to explore the issue further, and plan to continue their discussions in future meetings.

Financial Instruments

The Boards discussed the long-term objectives of the Financial Instruments project, progress to date, and the future work plan. The Boards affirmed their previous view that the main long-term objective of the project should be to measure all financial instruments at fair value.

The Boards also agreed that they would require disclosure of changes in fair value, cash receipts and cash payments for each type of financial instrument.

The Boards expect to provide detailed information on their Web sites regarding the long-term objectives and the status of the Financial Instruments project, and to develop a due process document on the reporting of disaggregated information on changes in fair values of financial instruments.

Conceptual Framework

The Boards continued their discussions aimed at developing a common conceptual framework. The Boards:

- discussed the process that may be used by the standard-setters to assess qualitative characteristics of financial information
- agreed to consider in November 2005 cost / benefit constraint issues from the preparer's point of view
- concluded that the process for assessing qualitative characteristics should be consistent for different types of private entities, but decided to consider not-for-profit and governmental entities at a later stage
- reviewed the staff's draft statement on the Objectives of Financial Reporting, and made several minor recommendations
- decided to develop an exposure draft as the first due process document for the objectives of financial reporting and consideration of qualitative characteristics.

IASB Observer Notes

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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