IFRS in Brief

June 2005, **Issue 14**

This issue of *IFRS in Brief* covers the May 2005 meeting of the International Accounting Standards Board (IASB).

Most of the Board's meeting focused on longer-term projects that are in early stages of development. These include:

- the conceptual framework, which is a joint project with the U.S. Financial Accounting Standards Board (FASB)
- reporting performance, for which the IASB discussed earnings per share and related issues
- a discussion paper on fair value measurement prepared by the Canadian standard setter
- the long-term insurance project.

The Board also finalised several projects:

- it agreed final changes on its financial instrument and risk disclosure project to be issued soon as IFRS 7
- it resolved issues for an exposure draft of significant changes to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

Provisions

The Board considered the issues raised by Board members during the review of a pre-ballot draft of proposed amendments to IAS 37.

The Board agreed to propose:

- to eliminate the exemption in the current version of IAS 37 from presenting comparative information in footnote disclosures and instead to require comparative information
- to require the application of the standard to annual periods beginning on or after 1 January 2007
- to clarify that all liabilities that are outside the scope of other standards would be within the scope of IAS 37
- to eliminate "provision" as a defined term and to replace it with "non-financial liability", without preventing the use of the term "provision" for certain subsets of liabilities
- to eliminate the terms "contingent asset" and "contingent liability", in part because many items currently considered to be contingent liabilities and therefore not recognised would be recognised under the proposed revised standard

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- to change the title of the standard to "Non-financial Liabilities".

Insurance Contracts – Phase II

At this meeting the Board considered different accounting approaches to non-life insurance contracts and tentatively agreed to focus its future discussions on two approaches:

- The first approach distinguishes between liabilities for claims for past events and the stand-ready obligation to pay valid claims for future insured events arising under existing contracts. The stand-ready obligation would be measured as the unearned portion of the premium, less deferred acquisition costs.
- The second approach accounts for insurance liabilities using the approach that the IASB and FASB are exploring in their joint project on revenue recognition. Under this approach unearned premium and acquisition costs would not be deferred. Instead, the insurer's contractual rights and obligations would be measured at from inception current exit value, with changes in value recognised in profit or loss.

Under both approaches, claims liabilities would be discounted and would include a risk margin. IAS 39 *Financial Instruments: Recognition and Measurement* would continue to apply to financial assets held by insurance companies.

The Board also discussed liability adequacy tests, estimation techniques, risks and uncertainties, and measurement approaches including discounting.

The next meetings of the Insurance Working Group are scheduled for 26 and 27 July and 28 and 29 September.

ED 7 *Financial Instruments: Disclosures*

The Board decided to finalise IFRS 7 in July 2005 without consequential amendments to the implementation guidance to IFRS 4 *Insurance Contracts* and to issue the consequential amendments to the implementation guidance to IFRS 4 later in 2005.

The Board also decided to:

- permit issuers of insurance contracts to satisfy requirements for a sensitivity analysis by using a value-based technique, such as embedded value, if the entity's management uses that method to manage and evaluate the entity's performance in accordance with a documented risk management or investment strategy even if that technique is not used to determine the entity's profit or loss
- require entities to provide sensitivity analyses for the whole of their business, but to permit different types of sensitivity analysis for different classes of financial instruments
- require the disclosure of day one profits that arise as a result of using of different valuation methods on initial recognition and for subsequent measurement.

The Board also noted that it expects to clarify in future revisions to the implementation guidance to IFRS 4 that:

- if a reasonably possible change in the risk variable would not trigger the liability adequacy test, then there may be no effect on profit or loss or equity, and therefore there may be no effect to disclose in the sensitivity analysis relating to that risk variable
- if a reasonably possible change in the risk variable would trigger the liability adequacy test, then the entity would disclose the effect on profit or loss or equity from the resulting change in the measurement of the liability
- the sensitivity analysis permits, but does not require, entities to consider the potential impact of future management actions that may offset the effect of changes in the risk variable under consideration.

The Board also expects to provide guidance to entities that measure insurance liabilities based on assumptions set by regulators. These entities should comply with the requirement to provide a sensitivity analysis and disclose how a reasonably possible change in the related risk variable would affect profit or loss or equity if such a change was applied to the assumption set by a regulator, regardless of whether the assumption may vary with market risks. An explanation of the limitations of such analysis also should be provided.

Performance Reporting – Joint Project with FASB

At the joint meeting of IASB and FASB in April 2005 the Boards decided to propose in Segment A of the performance reporting project that non-owner changes in net assets be presented in a single statement of earnings and comprehensive income. At this meeting the IASB decided to propose to:

- permit but not require the disclosure of comprehensive income per share in the notes to the financial statements
- require the presentation of earnings per share on the face of the statement of earnings and comprehensive income
- continue to require the disclosure in the notes to the financial statements of the weighted average number of shares used to calculate earnings per share.

The Board decided that amendments to IAS 33 *Earnings per Share* will not be required as part of Segment A of the performance reporting project.

Small and Medium-sized Entities (SMEs)

The staff informed the Board that the recognition and measurement questionnaire had been distributed to the respondents to the discussion paper, the Working Group and the Standards Advisory Council. The response period had been extended to 30 June 2005. A round table meeting on the recognition and measurement part of the project is planned for October 2005.

Previously the Board agreed to define SMEs as entities that do not have public accountability but publish general purpose financial statements for external users. At this meeting the Board discussed the components of this definition. The Board agreed that the definition of external users can be drawn from the IASB *Framework* and noted that owner-managers, tax authorities and non-securities regulators are not included in the definition. The Board also agreed that the definition of general purpose financial statements in IAS 1 *Presentation of Financial Statements* is applicable to SMEs. The Board also discussed the questions to be included in the planned presentation and disclosure questionnaire.

Conceptual Framework – Joint Project with FASB

The Board discussed qualitative characteristics of accounting information including relevance, reliability, verifiability and neutrality. The IASB will continue its discussions at its June and July 2005 meetings.

Measurement Bases for Financial Accounting

The Board considered a draft discussion paper *Measurement Bases for Financial Accounting: Measurement on Initial Recognition* developed by the Canadian Accounting Standards Board (AcSB) at the IASB's request. The Board agreed to issue the discussion paper. The Board also decided to:

- emphasise in the introduction to the discussion paper that the issues discussed in the paper have not been deliberated by the IASB yet and that the views expressed in the paper are those of AcSB
- explain the role of the discussion paper in the context of the IASB's conceptual framework project and FASB's project on fair value measurements.

International Financial Reporting Interpretations Committee (IFRIC)

IFRIC Interpretation on Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment

The Board approved a final interpretation based on IFRIC D10 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment*, subject to drafting suggestions.

The Board also decided that the interpretation will be included in IAS 37 when the standard is revised.

IFRIC D11 *Changes in Contributions to Employee Share Purchase Plans (ESPP)*

After considering the comments received on IFRIC D11 the IFRIC was unable to reach a conclusion on whether cessation of contributions to an ESPP by the employee should be accounted for as a cancellation, considered a forfeiture or not affect the accounting for the grant. The IFRIC referred the issue to the Board.

The Board noted that a requirement to pay contributions to an ESPP is not a vesting condition under IFRS 2 *Share-based Payment* and decided that cessation of contributions is a cancellation and not a forfeiture. The Board also decided to propose some clarifying amendments to IFRS 2.

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.

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 our member firms' offices.

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