IFRS in Brief

December 2005, **Issue 19**

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

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

Summary

At its November 2005 meeting, the Board:

- decided that it did not require a separate policy for technical corrections
- finalised an amendment to IAS 21 *The Effects of Changes in Foreign Exchange Rates* – Net Investment in a Foreign Operation, issued on 30 September 2005 as draft technical correction 1 (DTC1)
- discussed possible simplification of recognition and measurement principles contained in IFRSs as they relate to small- and medium-sized entities (SMEs)
- decided not to extend the convergence project on borrowing costs beyond elimination of the option in IAS 23 *Borrowing Costs* to expense borrowing costs immediately
- decided to propose amendments to IAS 33 *Earnings per Share* to converge with the proposals in an exposure draft published by the U.S. Financial Accounting Standards Board (FASB), and to propose extending the application of the amendments to convertible debt
- the Board also discussed its other projects, including control (consolidation), performance reporting, segment reporting, and business combinations, and held educational sessions on fair value measurement and re-insurance and insurance-linked securities.

Control (including Special Purpose Entities)

At the November 2005 meeting, the Board discussed its comprehensive project on the concept of control.

In the October 2005 issue of *IASB Update*, the Board published a statement in which it outlines its view that, under IAS 27 *Consolidated and Separate Financial Statements,* consolidation can be based on *de facto* control, and does not require the entity to hold a majority of voting rights. This statement acknowledged diversity in views under current IFRSs regarding application of a *de facto* control approach.

The control model being developed would avoid bright-line tests to determine whether one entity controls another, but would require expanded disclosures relating to how the existence of control was determined. The Board discussed the nature of disclosures that may be presented, but reached no decisions in this area.

Proposed Policy for Technical Corrections

The Board discussed comments that it received on its policy for technical corrections, which was published in August 2005, and decided that a separate policy for technical corrections was not necessary. The Board noted that some of its proposed technical corrections procedures were permitted under its current policies. Such procedures include a 30-day exposure period, and publication of an amendment only on the IASB web site. The Board voted against retaining the proposed policy.

Amendment to IAS 21 *The Effect of Changes in Foreign Exchange Rates*

The Board discussed comments received in response to DTC1. In light of the decision to abandon its policy for a separate "track" for technical corrections, DTC1 was considered as an amendment to IAS 21.

The Board's discussion focussed on the principle that a receivable from or payable to a foreign operation, for which settlement is neither planned nor likely to occur in the foreseeable future, is part of the entity's investment in that foreign operation.

It decided to add a new sentence to clarify that this principle may apply in the consolidated financial statements to a monetary item held by any subsidiary in the group (e.g., a loan from one subsidiary to another).

The Board decided to delete proposed paragraphs that elaborated further on the principle described above, by stating that a monetary item that is payable to an associate by the reporting entity or any of its subsidiaries shall not form part of the reporting entity's net investment in a foreign operation.

The Board also decided that application of the amendment would be effective for financial years starting on or after 1 January 2006, with earlier application encouraged.

SME Standard

The Board discussed possible simplifications of recognition and measurement principles as they apply to SMEs. Recommendations considered by the Board were based on the results of SME roundtables held in October 2005 and the SME Questionnaire issued in April 2005.

Lease Accounting

The Board voted against giving SMEs an option to treat all leases as operating leases and provide enhanced disclosures. At its future meetings the Board will explore further the following two alternatives for SMEs:

- treat all leases as finance leases, and simplify related measurement rules
- treat leases as either finance or operating based on the classification requirements in IAS 17 *Leases*, but simplify related measurement rules.

Investments in Associates and Joint Ventures

The Board tentatively decided that SMEs would have an option of either using the equity method of accounting for investments in associates or measuring them at fair value with gains and losses recognised in profit or loss. The Board decided that no major simplifications of IAS 31 *Interests in Joint Ventures* are needed for SMEs.

Impairment

The Board tentatively decided that SMEs could use an indicator approach for determining whether goodwill and other indefinite-lived intangibles are impaired, instead of performing impairment calculations annually. The Board decided to explore further possible simplification of accounting for impairment of non-financial assets other than goodwill and other indefinite-lived intangible assets.

Other Issues

The Board decided that no major simplifications or exemptions are needed for SMEs with respect to the following:

- measurement and recognition principles in IAS 2 *Inventories*
- percentage of completion method of accounting under IAS 11 *Construction Contracts* and IAS 18 *Revenue*
- consolidation of subsidiaries under IAS 27 *Consolidated and Separate Financial Statements.*

The Board decided that the following issues should be investigated further with preparers and users of SME financial statements:

- recognition of deferred income taxes under IAS 12 *Income Taxes*
- measurement of post-employment benefit liabilities under IAS 19 *Employee Benefits.*

Earnings per Share (EPS)

The Board discussed changes proposed in the FASB Exposure Draft on earnings per share (the FASB ED) published in October 2005. The FASB ED proposed changes to the treasury share method of computing EPS. The Board decided to propose amendments to IAS 33 *Earnings per Share* that would converge with the proposals in the FASB ED, except for the treatment of convertible debt securities. Unlike the FASB, the Board decided to extend the proposed changes to convertible debt. The Board will consider whether the amended treasury stock method also should apply to other convertible securities.

Business Combinations

The Board had an initial discussion of comments received on its exposure draft of proposed changes to IFRS 3 *Business Combinations* (BC phase II ED). The Board's discussion focussed on feedback from its recent roundtable talks that were held in Norwalk and London. The main comments arising from the participants included:

- little support for proposals to record all transactions involving non-controlling (minority) interests directly in equity and to measure goodwill at its full fair value even when a full 100 percent interest is not obtained
- participants felt there was no difference between acquiring an asset or acquiring a business and that in both instances acquisition-related costs should be capitalised
- concern over the definitions of "business" and the Board's proposal to focus the definition on whether a group of assets was "capable of" being operated as a business.

Other

The Board also:

- held educational sessions on fair value measurement and re-insurance and insurance-linked securities
- discussed a pre-ballot draft of the proposed exposure draft on segment reporting
- confirmed its previous decision to allow preparers a choice of presenting either a single statement of recognised income and expense, or two statements
- decided not to extend its short-term convergence project on borrowing costs beyond proposing to eliminate the expensing option currently available in IAS 23 *Borrowing Costs.*

IFRIC Update

The Board received an update on issues discussed by the International Financial Reporting Interpretations Committee (IFRIC) at IFRIC's meeting on 1-2 November 2005, including:

Service Concession Arrangements

IFRIC noted that IFRSs have to be applied in full to concession arrangements and therefore accounting policies must be assessed using the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. IFRIC decided not to pursue a project to create scope exceptions for service concessions. The IASB staff will prepare a project summary on concessions and post this on the IASB web site.

IFRIC D15: Reassessment of Embedded Derivatives

IFRIC decided not to expand the scope of D15 to address whether an assessment under IAS 39 *Financial Instruments: Recognition and Measurement* is required for contracts with embedded derivatives when those contracts are held by an entity acquired in a business combination.

IFRIC D16: Scope of IFRS 2

IFRIC is working to finalise this interpretation. In November 2005, IFRIC confirmed that the measurement date for share-based transactions in which the consideration exchanged is unidentifiable should be the grant date of the equity instrument.

Impairment and Interim Statements

In October 2005, the Board decided not to take on a project to amend IAS 34 *Interim Financial Reporting* to resolve inconsistencies with IAS 36 *Impairment of Assets* and IAS 39 *Financial Instruments: Recognition and Measurement* with respect to reversal of impairment losses on goodwill and equity instruments classified as available for sale investments.

At its November 2005 meeting, IFRIC noted that a potential conflict arises because IAS 34 can be read as regarding interim periods as discrete financial reporting periods or as an integral part of a single annual period. Under the discrete approach, impairments recognised in one interim period are not revised in subsequent interim or annual periods. However, under the integral approach a change in circumstances might justify reversal of previously recognised impairments. Prohibitions on reversal of certain impairments (i.e., of goodwill or equity investments classified as available for sale) would be overridden by the integral approach. IFRIC tentatively approved a draft interpretation precluding reversal of these impairments. IFRIC is expected to finalise and issue a draft interpretation in late January / early February 2006.

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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