

IFRS in Brief

April 2005, **Issue 12**

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

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

- The fair value option
- Financial guarantees
- Financial instruments puttable at fair value
- Business combinations – phase II
- Income taxes
- Segment reporting.

The Fair Value Option

The Board considered a number of issues related to the effective date and transition requirements of the revised fair value option amendment to IAS 39 *Financial Instruments: Recognition and Measurement*. The purpose of these amendments is to limit use of the fair value option to address concerns of regulators. The Board also held a round-table meeting with constituents to discuss the revised approach to the fair value option. The Board will discuss the revised draft of the fair value option amendment at its meeting in April 2005 and hopes to

issue a final version by July 2005. Currently the Board does not plan to re-expose the proposals for comment.

Transition Requirements and Effective Date

The Board decided that the amendment should be effective for annual periods beginning on or after 1 January 2006, with earlier application encouraged.

The Board agreed that if entities previously had *not* adopted a different version of the fair value option, then, at the date of adoption, they would be permitted to designate any financial assets or liabilities as measured at fair value through profit or loss if those items qualify under the amended fair value option. Such entities would be:

- first-time adopters that adopt the fair value option amendment at the same time as they adopt IFRSs
- existing users that adopt the fair value option amendment at the same time as IAS 39 (as revised in March 2004).

Existing IFRS users that previously had adopted a different version of the fair value option appear to be precluded from using the fair value option for existing assets and liabilities. These entities would have to de-designate the instruments that no longer qualify to be measured at fair value but

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otherwise would not be permitted to change the designation of the financial assets and financial liabilities to which the fair value option applies. For de-designated assets and liabilities, fair value would have to be used as deemed cost. The Board noted that under the E.U. "carve-out" version of IAS 39 entities would not have been permitted to apply the existing fair value option to certain financial liabilities. See IFRS Briefing Sheet, *IFRSs and the E.U. endorsement process: a status report* – issue 18, for a description of the E.U. carve out version of IAS 39.

The Board decided that entities should not be required to restate comparatives to reflect the application of the amendment.

Round-table Meeting

The participants at the round-table meeting expressed their overall support for the revised approach to the fair value option amendment. In response to the constituents' requests the Board agreed:

- to allow a "reasonable delay" in identifying a portfolio of financial assets and liabilities when an entity wishes to use the fair value option to eliminate or significantly reduce an accounting mismatch, subject to certain conditions
- to clarify that the documentation required to demonstrate that an entity manages and evaluates financial assets or financial liabilities on a fair value basis need not be as extensive as is required for hedge accounting and may be on a portfolio basis
- to clarify that the condition for "little or no analysis" refers to the analysis when the hybrid instrument first is considered. This applies in the context of assessing whether separation of an embedded derivative in a particular type of

hybrid instrument is required or prohibited by IAS 39, and hence whether the fair value option is available because it reduces complexity of accounting.

The Board rejected a proposal to permit designation of a component or proportion of an item as measured at fair value through profit or loss.

Financial Guarantees

Previously the Board tentatively decided to allow an entity to select one of two approaches to accounting for financial guarantees, either the approach in the exposure draft issued in July 2004 or the application of IFRS 4 *Insurance Contracts* with a more stringent liability adequacy test.

In March 2005, the Board considered a new possible approach. Under this new approach IAS 39 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, in which case an entity would be permitted to apply IFRS 4. An entity would have to apply the disclosure requirements of IAS 32 *Financial Instruments: Disclosure and Presentation* if it accounts for financial guarantee contracts under IAS 39 and the disclosure requirements of IFRS 4 if it accounts for such contracts under IFRS 4. The Board decided not to include an exemption for intra-group guarantees. The Board asked the staff to present a proposal based on this approach for consideration at its next meeting. The Board noted that it is likely to discontinue the project if it failed to reach agreement on a new proposal at its next meeting.

Financial Instruments Puttable at Fair Value

At this meeting the Board discussed a possible amendment to IAS 32 proposed by the staff of the Financial

Reporting Standards Board of New Zealand. The amendment would result in classification of certain financial instruments puttable at fair value as equity. The proposed amendment also included a set of criteria to prevent financial instruments puttable at fair value that have economic characteristics of a liability being classified as equity. The issues considered by the Board included:

- possible interaction of this project with the equity and liabilities project
- expanding the scope of the project to include puttable minority interests, limited life entities and partnerships with instruments puttable at fair value
- possible additional issues that may arise in specific jurisdictions.

In light of the Board's discussions, the representatives of the Financial Reporting Standards Board of New Zealand agreed to review the proposal with a view to expanding the project's scope.

Business Combinations – Phase II

The business combinations – phase II exposure drafts are expected in the second quarter of 2005. To lengthen the period for comment the Board hopes to post the exposure drafts on its Web site prior to publication by the national standard setters. The IASB hopes to use a comment period of 120 days from the posting date. The Board expects final versions of the proposed standards to be effective from 1 January 2007.

Income Taxes – Convergence with U.S. GAAP

Incorporating SFAS 109 guidance into IAS 12

At its January 2005 meeting the Board decided to consider whether to incorporate selected application guidance in SFAS 109 *Accounting for*

Income Taxes into IAS 12 *Income Taxes*. At this meeting the Board decided to include the SFAS 109 guidance on:

- annual computation of deferred tax assets and liabilities
- alternative minimum taxation requirements
- timing of recognition of the tax effects of a change in a tax status of the entity
- including tax planning strategies in determining the realisability of deferred tax benefits
- allocation of current and deferred tax within a group that files a consolidated tax return.

The Board will continue to explore developing converged guidance on special deductions.

Distributed Versus Undistributed Rate

In January 2005, the IASB decided that the tax rate applicable to undistributed profits is generally appropriate for measuring tax assets and liabilities arising from temporary differences. The Financial Accounting Standards Board (FASB) decided to use the distributed rate. At this meeting the IASB agreed to discuss this issue again at the IASB and FASB joint meeting in April 2005.

Financial Instruments: Disclosures

The Board resolved a number of open issues related to the drafting of the final standard based on ED 7 *Financial instruments: Disclosures*. The Board agreed that the standard should be effective from 1 January 2007 with earlier application encouraged. The Board also agreed not to require entities adopting the standard early to provide comparative information. The staff expected to distribute the pre-ballot draft in the beginning of April 2005 and deal with the sweep issues at the April 2005 Board meeting. The final standard is expected to be published in June 2005.

Segment Reporting – Convergence with U.S. GAAP

At its January 2005 meeting the Board agreed to add a convergence project to adopt the FASB's management approach to segment reporting and to issue an exposure draft proposing adoption of SFAS 131 *Disclosure about Segments of an Enterprise and Related Information* to replace IAS 14 *Segment Reporting*. Decisions at this meeting included:

- to include the requirements for interim period segment information in IAS 34 *Interim Financial Reporting* as a consequential

amendment of the new standard on segment reporting

- to follow the wording of SFAS 131 for the capital expenditure disclosure requirements in the new standard.

Other Issues

Other issues discussed at the meeting included:

- the possible scope and timing of a new long-term joint project with the FASB on financial instruments
- plans for the September 2005 round-table meeting on Non-publicly Accountable Entities (NPAEs).

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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