

IFRS in Brief

March 2006, **Issue 22**

This issue of *IFRS in Brief* covers the February 2006 meeting of the International Accounting Standards Board (IASB), recent announcements regarding convergence efforts with the U.S. and Japan, and the IASB's request for input on financial instruments.

IASB Meeting

At its February 2006 meeting the Board:

- discussed the proposed amendments to IAS 12 *Income Taxes* as part of the joint short-term convergence project with the U.S. Financial Accounting Standards Board (FASB)
- agreed to reconsider the definition of a business combination as part of phase II of the business combinations project
- agreed to defer the IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* project until work on related projects has been completed

- decided to amend IAS 1 *Presentation of Financial Statements* to include disclosure requirements for financial instruments puttable at fair value
- discussed various aspects of a draft standard for small and medium-sized entities (SMEs)
- considered the application of the allocated customer consideration approach to wholly executory revenue contracts
- discussed comment letters received in response to the proposed amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits*
- made several decisions concerning the definitions of an asset and a liability under the conceptual framework project
- discussed several issues related to phase II of the insurance project
- received an update on the FASB's project *Fair Value Measurement*.

Amendments to IAS 12 *Income Taxes*

The Board discussed several issues related to the proposed amendments to IAS 12 as part of the joint short-term convergence project with the FASB:

- The Board reviewed the staff's cost-benefit analysis of the amendments, which it agreed would be published with the exposure draft (ED).

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

- The staff proposed to limit the exemption from recognition of deferred tax balances concerning foreign subsidiaries and joint ventures to certain jurisdictions where intragroup distributions have tax effects. The Board rejected the proposal, but agreed to raise this issue as a question in the forthcoming ED.
- The Board received an update on the FASB's discussions in respect of uncertain tax items. In particular, the Board decided to follow the FASB's view concerning subsequent recognition and measurement: only information that is new to the entity should cause a change in the estimate of the expected outcome of a tax position. The Board agreed that the classification of interest and penalties (as part of income tax expense or not) should be an accounting policy election, but disagreed with the FASB that such interest and penalties should be disclosed.
- The Board agreed that current IFRS users should apply the amended standard prospectively. In the case of first-time adopters, the Board tentatively agreed upon application of the previous version of IAS 12 to balance sheets prior to the publication of the amendments, and the amended version of IAS 12 to subsequent balance sheets.

Business Combinations Phase II

The Board confirmed the guidance in the ED concerning joint ventures and removed them from the scope of the business combinations project.

The Board also discussed responses to the ED concerning the definition of a business combination, and agreed that the staff would present a proposal for a revised, more descriptive definition. If this proved unfeasible, the Board agreed that the

current definition would remain but would be supplemented by further guidance.

The basic principles of the business combinations project are due to be discussed in the March 2006 meeting of the IASB.

Government Grants

The Board reintroduced the discussion on amendments to IAS 20, which were last discussed in the Board's July 2004 meeting. The Board agreed to defer the IAS 20 project until work on IAS 37 and other related projects has been completed. This effectively meant that no decision was made on the progress of the emissions trading project.

Financial Instruments Puttable at Fair Value

The Board decided to amend IAS 1 *Presentation of Financial Statements* for disclosures in respect of financial instruments puttable at fair value, including:

- the rights attaching to such instruments
- changes in classification arising from changes in redemption conditions
- the entity's objectives, policies and processes in managing such instruments
- fair value information.

Accounting Standards for SMEs

The Board made a number of decisions in respect of its proposals for a standard for small and medium-sized entities, including the following:

- A mandatory fallback to full IFRSs is necessary, although in practice it should be an exception to the rule. The following (working) hierarchy was established: refer to IFRS for SMEs; search for analogy in another IFRS for SMEs; a

fallback to full IFRSs; and, finally, reference to the Framework. The Board decided to review this order at a later point.

- The scope of the standard was confirmed as non-publicly accountable entities that have not more than 50 employees.
- The balance sheet should include all line items.
- Both "functional" and "nature" expense analyses should be allowed in the income statement.
- A combined statement of income and retained earnings should be allowed where equity movements comprise only profit or loss and dividend payments.
- Consolidated financial statements should be prepared by SME groups.
- SMEs should have a choice of accounting for investments in associates and joint ventures: cost less impairment; fair value through profit or loss; the equity method; or proportionate consolidation for joint ventures.
- Property, plant and equipment may be revalued.
- Investment property may be accounted for using the cost model or the fair value model.
- Intangible assets with definite useful lives should be presented separately from goodwill. Separate presentation should not be mandatory for indefinite-life intangibles, which, together with goodwill, should be tested for impairment only when an indication of impairment exists.

Revenue Recognition

The Board considered the application of the allocated customer consideration approach to wholly executory (wholly unperformed) revenue contracts. It confirmed that the legal means at the disposal of the contracting parties in the case of breach of contract, either money

damages or enforced performance, should determine the unit of account of the contract.

The Board also discussed two revenue recognition methods: an extinguishment-based model and a performance-based model. The Board requested from the staff more examples of the application of the two methods before making any decisions.

IAS 37 and IAS 19 Amendments

The IASB staff presented the Board with a summary of the responses to the ED of the draft amendments to IAS 37 and IAS 19. The Board reaffirmed the relevance and importance of this project and decided to continue with it separately from the business combinations project. The Board concluded that further research and analysis by staff, and roundtable discussions, were required. A final standard is expected in mid-2007.

Conceptual Framework

Continuing discussions held in the IASB's December 2005 meeting, in this meeting the staff presented several issues related to the working definitions of an asset and a liability.

In respect of the definition of an asset, the Board tentatively decided that:

- the words "rights or other privileged access" should be used when referring to a resource, and "resource" should be rephrased as "economic advantage"
- there should be clarification that an asset's ability to generate economic benefits can be direct or indirect.

In respect of the definition of a liability, the Board agreed that:

- liabilities should be defined directly rather than by reflecting the asset definition

- besides potential cash outflows, the definition should explicitly include "other sacrifices of economic benefits" in order to incorporate events such as foregoing a cash inflow or an obligation to stand aside.

The FASB and the IASB intend to discuss the definitions in their joint meeting in April 2006.

Insurance Phase II

The Board made the following decisions in respect of its insurance project:

- Cash flows that depend on the policyholder renewing the contract are an intangible asset of the entity (customer relationship).
- A liability adequacy test is relevant for the unearned premium and current entry value approaches to measuring insurance liabilities.

There was preliminary discussion on the following issues, which will be considered further in future meetings:

- measurement models for life contracts
- acquisition costs
- gains on initial recognition of an insurance contract
- the measurement attribute for pre-claims liabilities.

Fair Value Measurement

The Board received an update on the FASB project *Fair Value Measurement*, but no decisions were made.

Convergence Efforts

U.S. GAAP

On 27 February 2006 the IASB and the FASB published a joint Memorandum of Understanding (MOU) that reaffirms the Boards' goal of developing a common international accounting framework.

The MOU does not represent a change to the principles and objectives described in the Norwalk Agreement published in October 2002, or the Boards' convergence work programme. The document includes a "roadmap" for the removal of the reconciliation requirement for IFRS users registered in the U.S., and reflects opportunities for improvement in the accounting standards identified by the Committee of European Securities Regulators.

The MOU sets out milestones for future convergence work, including a plan to identify major accounting differences that can be eliminated through short-term projects and to complete or substantially complete such projects by 2008.

Japanese GAAP

At their third joint meeting the IASB and the Accounting Standards Board of Japan (ASBJ) decided on an approach for achieving convergence between Japanese GAAP and International Financial Reporting Standards (IFRSs).

Differences that can be resolved relatively quickly will be addressed as part of a short-term project, while the remaining differences will be considered in a long-term project. Issues included in the short-term project will be resolved or will be in the process of being resolved by 2008.

Input on Financial Instruments

On 6 March 2006 the IASB and the FASB announced that they are seeking input from users of financial statements to determine their views on what information about financial instruments measured at fair value is useful to them in making investment and credit decisions. In addition, the Boards are interested in

understanding the cost-benefit relationship of providing information about such instruments. The request comes as part of the Boards' joint long-term project on financial instruments. Comments are invited by 14 April 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.

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