IASBriefing

This issue of IASB*riefing* covers the March 2004 meetings of the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC).

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Recent publications

Recent publications of the IASB and the IFRIC include:

- IFRS 3 *Business Combinations*;
- IFRS 4 *Insurance Contracts*;
- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;
- Macro hedging amendments to IAS 39 *Financial Instruments: Recognition and Measurement*; and
- IFRIC D5 *Applying IAS 29* Financial Reporting in Hyperinflationary Economies *for the first time*.

An overview of IFRIC D5 is provided in this issue. Summaries of IFRS 3, IFRS 4, IFRS 5 and the macro hedging amendments to IAS 39 are provided in IASB*riefing*, Issues 22 to 25, April 2004, respectively.

Financial instruments – fair value option (option to measure fair value changes through profit or loss)

In February 2004, the Board tentatively decided to limit the use of the fair value option in IAS 39 to three situations, but indicated that it would consider other situations where the option should be available.

During this meeting the Board continued its discussions of situations where the use of the fair value option should be permitted. In addition to the three situations discussed in February 2004, the Board tentatively decided to allow the option to measure assets at fair value with changes in fair value recognised in profit or loss to be applied to any available-for-sale financial assets other than loans or receivables. It indicated that these assets could be designated on an individual asset basis. There did not have to be a uniform accounting policy election (e.g., for the portfolio of available-for-sale financial assets).

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

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Other tentative decisions include clarifying that:

- financial assets or financial liabilities that contain one or more embedded derivatives would be eligible to use the fair value option, regardless of whether IAS 39 requires the derivative to be separated. A question is to be included in the exposure draft about whether the option should be restricted to those cases where an embedded derivative would be required to be separated;
- it will be possible to qualify to use the fair value option because a financial liability is linked contractually to the performance of assets only if the contract specifies the asset(s) to whose performance the holder is entitled. Therefore, the fair value option would not apply to discretionary participation features (e.g., those found in some insurance policies); and
- the requirement that exposure to changes in fair value be 'substantially offset' (as a condition for use of the fair value option) would not be interpreted as 'an exact offset'. Therefore, financial instruments whose exposure to changes in fair value is not *exactly* offset by the exposure to changes in the fair value of another financial asset or liability (including a derivative) *may* still be eligible to use the fair value option.

The Board also discussed one of its earlier tentative decisions summarised in the March issues of IASB *Update* as "For entities subject to prudential supervision such as banks and insurance companies, the powers of the relevant prudential supervisor may include oversight of the application of [the requirements in IAS 39 on how to determine fair value] and of relevant risk management systems and policies". The Board clarified that it was their intention to allow regulators to *restrict* what entities did when there was a choice within IFRSs, but that they were not allowing regulators to *change* the requirements of the IASB.

The Board also discussed transitional provisions for those entities currently using IFRSs who had applied the fair value option of revised IAS 39. It decided to solicit input in the comment period on this point.

The Board plans to review a pre-ballot draft of this exposure draft at its next meeting. It confirmed that the exposure draft would be subject to a 90-day comment period and the proposals would apply to financial periods beginning on or after 1 January 2005.

Business combinations (phase I) – scope of IFRS 3 *Business Combinations*

In December 2003, the Board decided to expand the scope of IFRS 3 to include business combinations involving two or more mutual entities as well as situations in which separate entities or businesses are brought together by contract to operate as a single reporting entity. It concluded that this decision would require re-exposure.

During this meeting the Board discussed various issues arising from its review of the pre-ballot draft as discussed below.

- Purchase price equation – the Board noted that some combinations would involve consideration that can be measured reliably. The Board decided to require, in these cases, that the cost of the combination be measured at the aggregate of:
  - the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities; and
  - the fair value, at the date of exchange, of the reliably measurable consideration. This amount would be recognised as goodwill.

  However, if the combination involved no consideration that could be measured reliably, the transaction would be measured at the net fair value of assets and liabilities acquired (i.e., no goodwill would be recognised on these transactions).
- Costs directly attributable to the combination – the Board decided to require any costs incurred in connection with these business combinations to be recognised immediately in profit or loss.
- Transitional provisions – the Board decided *not* to amend the transitional provisions in IFRS 3 and therefore to require entities to apply the amended IFRS 3 for any combinations after 31 March 2004.

Financial guarantees

In February 2004, the Board decided to issue an exposure draft that proposes measuring a financial guarantee that met the definition of an insurance contract and was not incurred or retained on transferring financial assets or liabilities to another party according to the requirements in IAS 39. IAS 39 requires the issuer to recognise a financial guarantee initially at its fair value and measure it subsequently at the higher of (i) the amount recognised under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, and (ii) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

At this meeting the Board stated that it intends to issue an exposure draft in April 2004 and that these proposals would be applied to reporting periods beginning on or after 1 January 2006. Earlier application would be encouraged and the proposals would be required to be applied retrospectively.

Consolidation

The Board discussed two aspects of the meaning of control in preparation to issue an exposure draft later this year.

- Power criterion – the Board tentatively decided that an entity has the power to control if:
  - it has a current ability to determine strategic, operating and financing policies and there is no third party with the (potential) ability to dominate policy determination; or

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– it does not dominate strategic, operating and financing policies but has the ability to do so. This is the case even if the entity previously has not dominated policy determination and/or has no intention of doing so.

- Power hierarchy – the Board tentatively decided to provide some guidance in the exposure draft on how to assess the concept of power and to specify that there would not be any rebuttable presumptions of control.

These decisions seem to confirm that the Board intends to retain the focus of current IAS 27 *Consolidated and Separate Financial Statements* on the *ability* to control rather than the *active exercise* of that control.

Convergence: IAS 12 *Income Taxes*

The Board discussed its convergence project on income taxes in preparation for its joint meeting with the US Financial Accounting Standards Board (FASB) in April 2004. It discussed the accounting for the tax effects of an acquisition of assets by an entity in a transaction that is not accounted for as a business combination and the amount paid is different from the tax base of the asset.
The Board tentatively decided that it would eliminate the exemption from recognition of deferred tax assets and deferred tax liabilities for such transactions that currently is in IAS 12. Instead it would propose requiring the entity to allocate the consideration paid between the assets and the related deferred tax asset or liability using a simultaneous equations method, with any tax benefit in excess of the cost of the related asset recognised immediately in profit or loss, but noted that this issue would be discussed again during the joint meeting.

IFRIC

IFRIC, the IASB's interpretative body, met in March 2004 and considered points arising from the Board's review of a final interpretation based on D2 *Decommissioning, Restoration and Similar Liabilities* in preparation to issue a final interpretation in April 2004. This Interpretation would have an effective date three months from issue. It decided to:

- remove obligations included in the cost of mineral rights and mineral reserves, thereby reverting to the scope of D2;
- modify the transitional requirements for first-time adopters of IFRSs to allow them to use a simplified method of transition. Retrospective application would be required for existing IFRS reporters; and
- clarify the treatment of revalued assets under this Interpretation.

Two draft interpretations are expected from IFRIC in April 2004 that discuss accounting for employee benefits.

IFRIC also discussed transition issues relating to recognition of impairment of equity investments classified as available-for-sale. Questions had come up in practice regarding whether application of revised IAS 39 (December 2003) should result in recognition of impairments as adjustments of prior periods. During IFRIC's discussion it was noted that while the previous version of IAS 39 described certain events that *may be* evidence of impairment, revised IAS 39 identifies events that it states *are* objective evidence of impairment. As a result, revised IAS 39 will require recognition of impairment where the previous version of IAS 39 would have permitted a conclusion to be reached that impairment has not occurred. IFRIC members noted that adoption of revised IAS 39 might lead to recognition of impairment in prior periods. Therefore, IFRIC decided an interpretation was not needed.

IFRIC D5 *Applying IAS 29* Financial Reporting in Hyperinflationary Economies *for the first time*

On 11 March 2004, IFRIC published D5, which proposes guidance to assist an entity restating its financial statements under IAS 29 in the first year in which it identifies the existence of hyperinflation in the economy of its functional currency.
The proposals would require an entity to apply IAS 29 as if it had always applied the standard, with certain exemptions. D5 also provides guidance on the calculation of opening deferred tax items.

D5 proposes retrospective application and it is expected that the final interpretation will be effective for entities adopting IFRSs for the first time in 2005.

IFRIC has invited comments on any aspect of D5. The deadline for submission is **14 May 2004**.

IASB Observer notes

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If you would like further information on any of the matters discussed in this IASB*riefing*, please talk to your usual local KPMG contact or call any of our member firm offices.

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