Updates on IASB and FASB financial reporting projects

The latest on progress related to financial instruments, leases, revenue recognition, insurance contracts and IFRS for SMEs

The International Accounting Standards Board has continued to be occupied with the completion of the four major projects being undertaken jointly with the United States Financial Accounting Standards Board:

- Financial instruments;
- Leases;
- Revenue recognition; and
- Insurance contracts.

In this connection, exposure drafts on impairment, leases and insurance contracts have been issued, while final standards will be issued for revenue recognition and hedge accounting.

Other than the four major projects, progress has also been made regarding the conceptual framework and the International Financial Reporting Standard for Small- and Medium-sized Entities.

Financial instruments

Classification and measurement

In November 2012, the IASB published an exposure draft *Classification and Measurement: Limited Amendments to IFRS 9 (Proposed amendments to IFRS 9 (2010))*. This exposure draft proposed limited amendments to the classification and measurement requirements for financial instruments already contained in IFRS 9 *Financial Instruments*. The main changes proposed in the draft were to clarify the notion of principal and interest, to propose the introduction of a "fair value through other comprehensive income" category for simple debt investments and to propose clarifications to the concept of "holding to collect" contractual cash flows.

The comment period for the IASB's exposure draft ended on 28 March. In May, a summary of the feedback received was presented to the IASB and the FASB. The FASB's comment period ended in late May. At future meetings, the FASB will share its feedback with the IASB and the proposals will be jointly redeliberated with the FASB with a view to completing deliberations on this project, along with the other phases of IFRS 9, in 2013.

Impairment

This is probably the most important part to overhaul the accounting for financial instruments. The objective of the project is to increase the usefulness of financial statements by improving the transparency of information about the credit quality of financial assets subject to impairment, and improving the timeliness of recognition of expected losses.

In March, the IASB published an exposure draft *Financial Instruments: Expected Credit Losses*, which was open for comment until 5 July. The proposals in that document are based on the model that the IASB had been developing jointly with the FASB. However, the model was simplified to address comments received from interested parties prior to publishing the exposure draft. Importantly, the proposals would result in expected credit losses always being recognized (from when a financial instrument is first purchased or originated) with full lifetime expected credit losses being recognized when a financial instrument suffers a significant deterioration in credit quality.

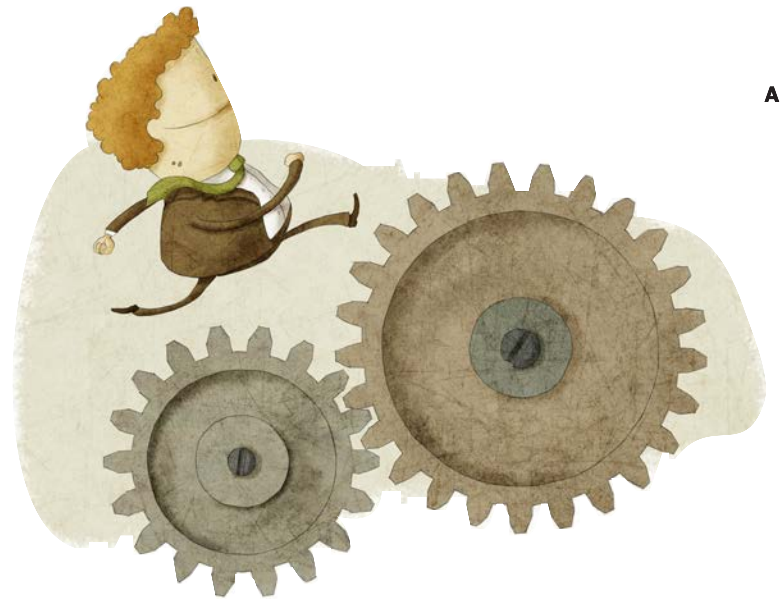
Even though the Financial Stability Board and the G20 view a converged solution as important, in July 2012 the FASB decided to explore a different approach – one still based on expected credit losses but in which full (all) lifetime expected credit losses are recognized for all loans from initial recognition. The IASB does not support the recognition of full lifetime expected credit losses when a loan is first recognized, preferring a model that will result in lifetime expected credit losses only being recognized once the credit quality on a loan deteriorates and an economic loss is increasingly likely to result. In this connection, the IASB continues to have an open line of communication with the FASB and joint outreach is being undertaken that one of which was taken place in Hong Kong in June.

During the comment period, the IASB was also undertaking field work to determine how the IASB proposals on expected credit losses respond to changing economic circumstances over time. It was also designed to provide an understanding of how the proposals may be implemented and to provide some information about the directional impact on allowance balances. The field work was detailed and undertaken with 14 participants from the major regions across the world. The participants included banks, with various levels of sophistication of products and credit risk management, and some non-bank corporations.

Hedge accounting

The objective of this project is to improve hedge accounting by more closely aligning it with a company's risk management activities, thereby improving financial reporting. In September 2012, the IASB posted a review draft on its website of the forthcoming hedge accounting requirements to be added to IFRS 9.

In January, the key issues raised on the review draft were discussed and the IASB tentatively agreed to make some changes and clarifications to the document based on the feedback received. In April, the IASB finalized its deliberations on hedge accounting and granted the staff permission to draft the final



hedge accounting requirements for inclusion in IFRS 9. Pending the outcome of the project on accounting for macro hedges, the IASB also decided to provide entities with a choice between applying the new hedge accounting requirements of IFRS 9 or continuing to apply the hedge accounting requirements in IAS 39 *Financial Instruments: Recognition and Measurement*. This will allow entities to wait for the final picture related to accounting for macro hedging activities before applying the new hedge accounting model in IFRS 9.

Leases

The objective of the leases project is to improve the quality and comparability of financial reporting by providing greater transparency about leverage, the assets an entity uses in its operations and the risks to which it is exposed from entering into lease transactions.

This is a joint project with the FASB. In May, both boards published a joint and revised exposure draft on *Leases*, which is open for comment until 13 September. Under the proposals, a lessee would report assets and liabilities for all leases of more than 12 months on its balance sheet. The recognition of lease-related expenses in the lessee's income statement for most real estate leases would be different from that for most other leases, to better reflect the differing economics of those leases. The exposure draft also proposes some changes to the accounting applied by many equipment and vehicle lessors, which would better reflect how such lessors price their leases.

Revenue recognition

The objective of this project is to improve financial reporting by creating a common revenue recognition standard that clarifies principles that can be applied consistently across various transactions, industries and capital markets. The project applies to all contracts with customers (except leases, financial instruments and insurance contracts).

This is also a joint project with the FASB. The boards have completed their redeliberations of the 2011 exposure draft. In May, the IASB confirmed that all due process steps have been complied with, and gave the staff permission to ballot the final standard. The boards will ballot and issue the final standard at the same time, which is expected to be in the third quarter.

Because of the importance of revenue and the broad scope of the new standard, the IASB is considering creating an implementation group with a limited life to support preparers as they make the transition to the new standard. This would be a joint group with the FASB and would provide a public forum for discussion of implementation issues.

Insurance contracts

In 2012, the IASB decided that, on the basis of the feedback received on the original exposure draft and the subsequent decisions made during redeliberations, it would re-expose its proposals. As a result, an exposure draft was issued in June. The objective of this project is to eliminate inconsistencies and weaknesses in existing practice by replacing IFRS 4 *Insurance Contracts* and to provide a single principle-based standard to account for all insurance contracts. While the boards have worked together on this project, different decisions have been reached on several basic matters. For example, while both boards have agreed to measure the insurance liability using a current measure of the estimated costs to fulfil the obligation, the boards have reached different decisions on several aspects of the model, including recognition of changes in estimates, the inclusion of a risk margin in the measurement of the liability and the treatment of acquisition costs.

Because of the importance of completing this project, and in view of the extensive debate the IASB has undertaken over the years, the board decided that feedback will only be sought on five key matters on which there have been significant changes to the proposals in the 2010 exposure draft. In addition, the IASB will seek feedback on the extent to which the benefits of its revised proposals justify the additional complexity those proposals introduce, and whether the drafting of the standard is clear.

The conceptual framework

The IASB restarted this project in September 2012, which builds on the work previously done before the project was paused in 2010. As part of that work, the IASB completed chapters on the objective of financial reporting and qualitative characteristics of useful information.

The IASB has spent an extensive amount of time in discussing this project. In addition, the IASB is obtaining input on this project from the newly formed Accounting Standards Advisory Forum, which serves as a technical advisory body to the IASB and consists of various members of the global accounting standard-setting community. The inaugural ASAF meeting held in April was mainly devoted to discussing this project.

A discussion paper was released in July. The comment period is 180 days.

IFRS for SMEs (comprehensive review 2012 – 14)

When the IASB issued the IFRS for SMEs in 2009, it stated that it would undertake an initial comprehensive review of the standard. This review would allow the IASB to assess the first two years' experience in implementing the standard and consider whether there is a need for any amendments. In mid-2012, the IASB commenced the initial comprehensive review by issuing a request for information, seeking public views on whether there is a need to make any amendments to the IFRS for SMEs.

The IASB started to discuss the issues in the request for information in March. It is expected that an exposure draft will be issued in the second half of this year.

This article is contributed by the Institute's standard setting department.