

31 DECEMBER 2014 – UPDATE ON KEY IASB PROJECTS INTERNATIONAL FINANCIAL REPORTING BULLETIN 2014/24



Background

The International Accounting Standards Board (IASB) is currently working on a number of major projects that are at various stages of completion. A number of these are likely to impact most entities to varying degrees.

There is no requirement for entities to make disclosures regarding outstanding IASB projects in their 31 December 2014 financial statements. However, because of the potential effects of the new standards that will ultimately be issued, it is advisable to keep a watching brief on the status of those projects and key (tentative) decisions that have been taken by the IASB.

This IFRB sets out a summary of four of the most significant current IASB projects. These are:

1. Leases
2. Insurance Contracts
3. Conceptual Framework
4. Disclosure Initiative.

STATUS

IASB projects

EFFECTIVE DATE

To be confirmed

ACCOUNTING IMPACT

Likely to be significant for all entities.

Summary

1. Leases

The revised exposure draft ED/2013/6 replaced ED/2010/9 in May 2013. In response to the revised exposure draft the IASB received extensive feedback from various stakeholders and reached important tentative decisions throughout 2014. A final Standard is yet to be published by the IASB, and is currently scheduled for release in the second half of 2015.

In August 2014 the IASB published a *Project Update* on leases that included the most recent update on tentative decisions reached on the project during the first half of 2014. A major change from the proposals set out in ED/2013/6 is the tentative decision of the IASB to return to a single lessee accounting model in order to reduce complexity.

The single lessee accounting model, which was proposed in ED/2010/9, requires the recognition of interest and amortisation for all leases recognised on a lessee's balance sheet. As a result, a lessee would be required to recognise fixed assets and financial liabilities and corresponding amounts of amortisation and interest. An exception has been proposed for short-term leases and leases of small assets, but this has yet to be confirmed.

In contrast, the FASB has tentatively decided to adopt a dual model that retains the existing distinction between finance and operating leases. Under the dual model, leases would be accounted for as financing transactions only if the lease would meet the current definition of a finance lease. For those which would currently be accounted for as operating leases, the finance charge and depreciation charge would be aggregated and disclosed as a single line item in profit or loss.

However, there are similarities between the current IASB and FASB proposals, which currently result in a partially converged model for the accounting for leases under IFRS and US GAAP. Convergence was reached with regard to the:

- Balance sheet presentation, where leases are to be reported on the balance sheet under both the IASB and the FASB model
- Definition of a lease
- Measurement of lease liabilities.

However, differences will remain due to the different models. While off balance sheet presentation will be avoided under both models, differences remain for the presentation of:

- Lease expenses in the income statement; and
- The cash flow statement.

The accounting for leases by the lessor will remain unchanged. Based on the feedback received on ED/2013/6, it was concluded that the benefits obtained from changing lessor accounting would not outweigh the costs, and that a symmetrical lessee and lessor accounting model is not essential.

Next steps

The IASB and the FASB are currently in the process of their final redeliberations. Apart from the tentative decisions reached by the IASB and the FASB in 2014 some remaining issues still need to be finalised and will be discussed in early 2015:

- Definition of a lease vs. service
- Lessee disclosures and transition
- Small ticket item exception
- Effective date.

The publication of the final leases standard is expected in the second half of 2015.

2. Insurance Contracts

In June 2013 the IASB published the revised exposure draft ED/2013/7 which replaced the original exposure draft ED/2010/8 that was published in July 2010.

Like the previous ED, the revised ED proposes that an entity measures insurance contracts using a current value approach and covers all types of insurance contracts issued by all entities (not only insurers).

The key changes from the original ED are:

- The insurance liability would include a contractual service margin (i.e. expected profit on the contract) that is 'unlocked' i.e. the margin would be adjusted for changes in assumptions relating to future coverage and services
- Insurance contracts for which cash flows are contractually linked to, and vary directly with an underlying item, would use the carrying amount of the underlying item to account for such cash flows
- Gross presentation of insurance contract revenue and claims/expenses incurred (the original ED proposed a single net margin line item in the statement of comprehensive income)
- Interest expense recognised based on amortised cost, and all other current value changes recognised in other comprehensive income
- Full retrospective approach to transition if practicable and with a modified retrospective approach otherwise.

The IASB's response to the feedback received on the revised exposure draft ED/2013/7 was published in October 2014 and is split into feedback on the areas targeted by the ED and additional areas that the IASB decided to consider based on its April 2014 meeting.

The key tentative decisions of the IASB with regard to the feedback received on ED/2013/7 are:

- Confirmation of proposal for the unlocking of the contractual service margin (CSM) with additional clarification that an entity should unlock the CSM for changes in risk relating to future services and that favourable changes should reverse certain losses previously recognised in profit or loss
- Confirmation of the proposal that revenue and expenses should be presented in comprehensive income. No premium information should be presented in the statement of comprehensive income
- Confirmation of the proposed revenue disclosures
- Provide a policy choice to present the effect of changes in the discount rate either in other comprehensive income (OCI) or in profit or loss and therefore eliminate the previous proposal to present changes only in OCI
- Confirmation of the transition requirements for retrospective application together with the option to either apply a simplified approach or the fair value approach if retrospective application is impracticable.

Tentative decisions on additional issues not targeted by the exposure draft:

- Entities are permitted to apply IFRS 15 *Revenue from Contracts with Customers* to fixed-fee service contracts that meet the definition of an insurance contract
- Confirmation that discount rates used to adjust cash flows in insurance contracts need to be consistent with observable current market prices
- Confirmation of the revenue recognition principle proposed in ED/2013/7 and to clarify that for contracts with no participating features, the service represented by the CSM is the insurance coverage provided on the basis of the passage of time with consideration being given to the expected number of contracts in force
- Changes in estimates of fulfilment cash flows for a reinsurance contract should be recognised immediately in profit or loss when the change arises as a result of changes in estimates of fulfilment cash flows for an underlying direct insurance contract that are recognised immediately in profit or loss
- Contracts acquired in their settlement period should be accounted for as if they were issued on the date of transfer
- Aggregation of contracts is acceptable if the objective of the standard is met. However, it is not acceptable to aggregate onerous (or loss making) contracts with profit making contracts when calculating the CSM or loss on initial recognition
- A significant insurance risk arises only when there is a possibility that an issuer will incur a loss on a present value basis.

In November 2014, the IASB published a project update that summarised the recent status of the project and the next steps for the finalisation of the project. The IASB has also met a number of industry representatives to discuss certain key aspects of the proposals.

Next steps

The IASB is redeliberating the feedback received and expects to meet in early 2015 for further discussions. The final insurance contract standard is currently expected to be published in late 2015.

For more information please refer to the BDO *IFR Bulletin* publication, 2013/19 *Insurance Contracts*, available from the below link:

<http://www.bdointernational.com/Services/Audit/IFRS/IFR-Bulletins-2011/IFRB%202013/IFRB-2013-19.pdf>

3. Conceptual Framework

In July 2013 the IASB released Discussion Paper DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting*.

The Discussion Paper was designed to obtain initial views and comments to be taken into consideration in preparing a subsequent Exposure Draft for the revision of the *Conceptual Framework*.

Key areas of focus included those that have both:

- Been known to have caused application issues in practice
- Require updates in order to be consistent with concepts developed by the IASB in other projects it has completed and/or is currently undertaking.

At a high-level these areas of focus included:

- Definitions of assets and liabilities
- Recognition and derecognition of assets and liabilities
- Measurement
- Equity
- Profit or loss and other comprehensive income (OCI)
- Presentation and disclosure
- Additional matters (including business model, unit of account, going concern, and capital maintenance).

The deadline for comments on the Discussion Paper ended on 14 January 2014. The IASB substantially completed its redeliberations at its November 2014 meeting and published a summary of the IASB's tentative decisions made. The key tentative decisions of the IASB in 2014 are:

- Changes in the definitions and discussions about assets/liabilities and income/expenses
- Inclusion of concepts explaining the nature of assets/liabilities in executory contracts
- Not to remove the reference to control from the definition of an asset
- Retain the materiality definition from the existing framework
- Increase the prominence of stewardship
- Reintroduce the concept of prudence, in the context of this being an appropriate level of caution when uncertainty exists, and not a deliberate bias.

Next steps

The IASB has substantially finalised its redeliberations and plans to publish an Exposure Draft in the first quarter of 2015.

4. Disclosure Initiative

The Disclosure Initiative was introduced by the IASB in order to explore the potential for the improvement of disclosures in financial statements.

The initial feedback received on the project was based on a *Discussion Forum on Disclosure in Financial Reporting* which was held in January 2013 to foster discussion about disclosures between preparers, regulators and auditors. Further information were gained through a survey that was conducted by the IASB and a corresponding feedback statement published in May 2013.


The Disclosure Initiative is made up of the following separate projects of which the current status and the next steps are summarised below:

Implementation projects

- *IAS 1 amendments* – Consist of narrow focus amendments to IAS 1 that are based on a ED/2014/1 which was published in March 2014 and for which the comment period ended in July 2014.
In October 2014 the IASB made the tentative decision that subtotals in the statement of profit or loss and other comprehensive income (OCI) should be consistent with the subtotals of the statement of financial position. However, it was clarified that these subtotals need not be consistent with subtotals in other areas of the financial statements.
The IASB has completed its redeliberations in response to the feedback received on the ED and expects to publish the final Standard in December 2014.
- *Reconciliation of liabilities from financing activities* – Consideration of amendments to IAS 7 *Statement of Cash Flows* with regard to the disclosures about restrictions on cash and cash equivalents.

Research projects

- *Materiality* – Seek information on the application of materiality in IFRS financial statements in order to assess whether further guidance is required. The IASB requested help from national standard setters in order to obtain relevant information to assist in consideration of the next steps. A summary was discussed by the IASB in the third quarter of 2014. Based on that discussion, the IASB tentatively decided to align the definition of materiality with the definitions in IAS 1 *Presentation of Financial Statements*, IAS 8 *Accounting Policies, Changes in Estimates and Errors* and the *Conceptual Framework*.
- *Principles of Disclosure* – Identification and development of a set of principles for disclosures based on a review of IAS 1, IAS 7 *Statement of Cash Flows* and IAS 8. Tentative decisions of the IASB were made in the third and fourth quarters of 2014, with highlights including:
 - Provision of high level guidance for formatting information in the notes
 - General principle for disclosing information required by IFRS outside financial statements (cross referencing).
- *Standard-level review of disclosure* – Research for conflicts, duplications and overlaps in existing Standards. The project is being informed by the results of the *Principles of Disclosures* project.



This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact your respective BDO Member Firm to discuss these matters in the context of your particular circumstances. Neither BDO IFR Advisory Limited, Brussels Worldwide Services BVBA, BDO International Limited and/or BDO Member Firms, nor their respective partners, employees and/or agents accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

Service provision within the international BDO network of independent Member Firms ('the BDO network') in connection with IFRS (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board, is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is coordinated by Brussels Worldwide Services BVBA, a limited liability company incorporated in Belgium with its statutory seat in Brussels.

Each of BDO International Limited (the governing entity of the BDO network), Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and the Member Firms is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and/or the Member Firms of the BDO network.

BDO is the brand name for the BDO network and for each of the BDO Member Firms.

© 2014 BDO IFR Advisory Limited, a UK registered company limited by guarantee. All rights reserved.

www.bdointernational.com

