

IASBriefing

This issue of *IASBriefing* covers the International Accounting Standards Board's (IASB) February 2004 meeting and the February 2004 meeting of the International Financial Reporting Interpretations Committee (IFRIC). A summary of the IASB's project plan is included in Attachment One.

Highlights

At its February meeting the Board:

- decided to revise the recently published IAS 39 *Financial Instruments: Recognition and Measurement* to limit use of the fair value option;
- modified the definition of a discontinued operation proposed under ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations*;
- agreed to clarify and amend hedge effectiveness tests as part of finalising the macro hedging amendment. Some of these changes would apply to all hedge effectiveness tests, not just macro hedging. In particular, the Board decided to remove the 'almost fully offset' requirement in the prospective hedge effectiveness test;
- decided to re-expose its recent conclusion to measure financial guarantees that meet the definition of an insurance contract according to the requirements in IAS 39; and
- accelerated its plan to withdraw IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

Financial instruments – fair value option

The Board sought to respond to significant concerns expressed by some regulators about the potential for misuse of the 'fair value option' included in IAS 39. The fair value option allows entities to designate any financial asset or financial liability, irrevocably on initial recognition, to be measured at fair value with changes in fair value recognised in profit or loss. The Board discussed this issue and tentatively decided that it would propose a revision to limit the use of the option to specified situations.

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

The following proposals will be published in an exposure draft. Therefore, these proposals will *not* be finalised before 31 March 2004.

According to the February 2004 issue of IASB *Update*, the use of the fair value option would be limited to the following financial instruments:

- the item is a financial asset or financial liability that contains one or more embedded derivatives as described in IAS 39 paragraph 10; or
- the item is a financial liability whose amount is linked contractually to the performance of assets that are measured at fair value; or
- the exposure to changes in the fair value of the financial asset or financial liability is substantially offset by the exposure to changes in the fair value of another financial asset or financial liability, including a derivative.

However, the Board identified other cases where it would like to continue to make the fair value option available. It tentatively decided to allow the fair value option for any available-for-sale financial asset other than a loan or receivable. This will be discussed further at a future meeting.

Other tentative decisions included to:

- clarify in IAS 39 that the fair value option could be used only for items whose fair value is verifiable, and to note that the application of the fair value requirements of IAS 39, in a manner consistent with the entity's risk management policies and objectives, may be subject to the oversight of a prudential supervisor; and
- retain the condition contained in IAS 39 requiring any election of the fair value option to be irrevocable.

Business combinations (phase I) and IAS 36 *Impairment of Assets*

The Board discussed an issue that was raised by an amendment to IAS 36 as a result of the improvements project. Some Board members were concerned that the amended requirements of IAS 36 may be misinterpreted as prohibiting an entity from including, in projections of future cash flows, future costs necessary to maintain the level of economic benefits expected to arise from an asset in its current condition. The Board clarified that this was not its intent and asked the staff to revise the wording to clarify that the requirements of the previous standard were unchanged in this respect. The modified wording may be adopted as part of the consequential amendments to IAS 36 arising from publication of IFRS 3 *Business Combinations*.

ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations*

The Board concluded its discussion of the comments it received in preparation to issue a final standard by the end of March 2004.

The main issue discussed by the Board was the definition of a discontinued operation. This issue was being discussed as a result of the current issues encountered in implementing US Statement 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*, on which ED 4 was based. The IASB debated various approaches and decided to retain the definition of a discontinuing operation in IAS 35 *Discontinuing Operations*. This decision would result in convergence on timing of recognition and classification requirements only. The Board also concluded that it should work with the US Financial Accounting Standards Board to explore further the definition of a discontinued operation to achieve full convergence in this area at a later date.

The Board also decided to modify the requirements related to associates and joint ventures acquired and held for resale in IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*. Currently these standards require such investments to be accounted for as a financial asset under IAS 39. Instead, the Board would add requirements outlining the accounting for associates and joint ventures that meet the criteria to be classified as held for sale. The new requirements would be to consolidate these investments as assets (or disposal groups) held for sale, thereby achieving consistency in the treatment of investments in subsidiaries, associates and joint ventures that are held for sale.

Employee benefits

The Board continued its discussions of its 'fast track' project on employee benefits. As part of this new project the Board intended to modify the IAS 19 *Employee Benefits* requirements for separate financial statements of entities that were subsidiaries of a group and participated in a group scheme. Concerns were raised regarding the ability of such entities to prepare the information required by IAS 19, particularly when the group has a significant number of employees transferring across various subsidiaries. The Board tentatively decided that if an entity is exempt from presenting consolidated financial statements under IAS 27 *Consolidated and Separate Financial Statements*, the entity should account for the plan as a multi-employer plan under IAS 19 in its separate financial statements.

Other tentative decisions include to:

- not create a separate component of equity representing the defined benefit asset or liability recognised directly in equity;
- require actuarial gains and losses that are recognised outside the income statement to remain in retained earnings and not require them to be included as a separate classification within equity;
- classify the impact of the asset ceiling as an actuarial gain or loss when the immediate recognition option is used. Therefore, if an entity recognises actuarial gains and losses outside the income statement, the impact of the asset ceiling also should be recognised outside the income statement; and

- restrict sensitivity disclosures to information relating to health-care cost trend rates.

IFRIC is working on an interpretation on accounting for multi-employer defined benefit plans. As part of this planned interpretation, IFRIC asked the Board to amend IAS 19 to require state pension plans to be treated as defined contribution plans. The Board approved IFRIC's plan to propose this amendment.

Exposure draft – Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk

The Board considered the following final points that arose from the comments it received on its macro hedging exposure draft published in August 2003.

- *Hedge effectiveness* – The Board confirmed that the effectiveness test in IAS 39 applied to a portfolio hedge of interest rate risk ('macro hedging'). It also decided to amend the words 'almost fully offset' and replace them with 'highly effective', as set out in US GAAP. It also will provide further guidance on the application of the effectiveness tests. Further, in applying the prospective effectiveness test, the Board decided that effectiveness should be assessed over the period to the next rebalancing date and *not* over the full life of the hedge. In applying the retrospective effectiveness test, the assessment *could* be based on all time buckets in aggregate instead of individually for each time bucket. The Board also clarified that when the hedged item is designated as a portion of a position, ineffectiveness should be measured by looking only at changes in that designated portion.

The proposed amendments with respect to the prospective effectiveness test and the hedging of portions will apply to hedge accounting in general and not only to macro hedging.

- *Amortisation* – The Board considered various methods to amortise the separate balance sheet line item, either an asset or a liability, that arises as a result of macro hedging. It tentatively decided that in the case of macro hedging, the line item balance should be amortised (a) on the basis of a recalculated effective interest rate, when practicable; or (b) when not practicable, using a straight-line method. The balance should be amortised over the period during which the assets or liabilities to which it relates are derecognised.
- *Transitional provisions* – The Board recognised that there was confusion regarding the proposed transitional requirements. To clarify the proposals, the Board agreed:
 - to provide additional guidance on how entities should transition from cash flow hedge to fair value hedge accounting;
 - not to permit a fair value macro hedge to be designated retrospectively;
 - not to provide special guidance for entities that wish to apply fair value hedge accounting on their portfolio hedges

where possible, but that do not meet the conditions to do so for all time buckets. Instead, the requirements in IAS 39 (December 2003) for discontinuing fair value or cash flow hedge accounting and for re-designating a hedge should apply; and

- to require adoption of these requirements at the same time as the revised IAS 39.

Insurance contracts

The Board considered an issue that arose during the preparation of a final standard based on ED 5 *Insurance Contracts*. In January 2004 the Board had decided that if a financial guarantee met the definition of an insurance contract and it was not incurred or retained on transferring financial assets or liabilities to another party, the contract was within the scope of a standard based on ED 5, but that it should be measured according to the requirements in IAS 39. IAS 39 requires the issuer to recognise the financial guarantee initially at its fair value and measure it subsequently at the higher of (a) the amount recognised under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and (b) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*. The Board decided that the above conclusion would require re-exposure. Therefore, the IASB will finalise a standard by the end of March 2004 based on the measurement model proposed in ED 5 and issue an exposure draft reflecting the measurement model described above.

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

Previously, the Board tentatively decided to withdraw and replace IAS 20. During the February 2004 meeting, it discussed the best approach to accelerate this project as this would be a temporary measure, given its current project on revenue recognition, and its need to deal with this issue quickly to assist IFRIC with its work on emission rights. The Board decided that in light of other projects, it was too early to specify a new model and that the withdrawal of IAS 20 would leave insufficient guidance. Consequently, the Board tentatively decided that the best approach would be to revise IAS 20 by adopting the accounting model for government grants in IAS 41 *Agriculture*. The Board asked its staff to develop proposed amendments to IAS 20.

Business combinations (phase II)

The Board continued its discussions in preparation for issuing an exposure draft in the second quarter of 2004. Specifically, it discussed an earlier decision to not recognise acquired contingent assets separately from goodwill, and tentatively decided to:

- clarify that a significant contract in the process of being negotiated between the acquiree and a new customer ('pending customer contract') meets the proposed definition of a contingent asset. A customer would be a new customer if the acquiree and the customer had no contractual relationship in the past; and

- include the value of a pending customer contract in goodwill, as it does not give rise to rights that would qualify for separate recognition at the acquisition date.

The Board recognises that the possible value of this contingent asset will remain in goodwill even if the contract is finalised shortly after completion of the business combination. The Board intends to redeliberate accounting for acquired contingent assets and contingent liabilities.

IFRIC

IFRIC, the IASB's interpretative body, met in February 2004 and considered points arising from drafting an interpretation based on *D2 Decommissioning, Restoration and Similar Liabilities* in preparation to issue a final interpretation towards the end of March 2004. It decided to:

- expand the scope of the interpretation to include mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources; and
- exclude the cost of *new* obligations arising from changes of law.

It is expected that the interpretation will have an effective date of **1 July 2004**.

IFRIC also discussed *D1 Emission Rights* in light of the Board's project on IAS 20, as described above. It tentatively decided to re-expose its interpretation at the same time the Board exposes its IAS 20 proposals.

Other draft interpretations are expected from IFRIC in the upcoming months discussing some issues surrounding accounting for employee benefits. A draft interpretation also is expected that will provide guidance on how an entity should restate its financial statements when it first identifies the existence of hyperinflation.

IASB Observer notes

KPMG has arranged to make available copies of the IASB Observer, a publication of European Research Associates Limited, to our clients and contacts. The IASB Observer provides timely, detailed reporting of IASB meetings. Please talk to your usual contact at KPMG to receive this publication.

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Supplementary Attachment: IASB's project plan

The following is a summary of the International Accounting Standards Board's (IASB) current project plan.

Project description	Overview	Timing/Status
Business combinations phase I	The proposals would eliminate the uniting-of-interests method of accounting for business combinations; amortisation of goodwill and some other intangibles would cease and negative goodwill would be recognised immediately in profit or loss. Contingent liabilities acquired would be recognised and measured at fair value. An objective of the project is convergence with current US GAAP, although there will not be convergence with the US GAAP measurement of impairment of goodwill.	Exposure drafts (EDs) were issued in November 2002. The comment period closed in April 2003 and a final standard is expected to be issued in March 2004. Another exposure draft is scheduled to be issued in the second quarter of 2004 that would propose including mutual entities within the scope of the final standard.
Business combinations phase II	This is a joint project with the US Financial Accounting Standards Board (FASB) that addresses issues dealing with the application of the purchase method of accounting for business combinations. It would require entities to adopt the full goodwill method when acquiring less than 100 per cent of an entity. It also would include significant revisions to the accounting for minority interests, which would be treated as part of group equity.	An ED is scheduled for release in the second quarter of 2004, to be followed by a 90-day comment period.
Consolidation and special purpose entities (SPEs)	The objective of this project is to reconfirm the basis on which an entity should be consolidated, including SPEs.	The project is in its early stages. The Board plans to complete an ED by the end of 2004.
Convergence project (short-term)	This is a joint project with the US FASB whose objective is to reduce the differences between International Financial Reporting Standards (IFRSs) and US GAAP. This project plans changes to a number of existing standards including income taxes, government grants and discontinuing operations.	<i>Disposals of Non-current Assets and Presentation of Discontinued Operations</i> (ED 4) was the first ED issued under this project. Other EDs are scheduled for release throughout 2004. A standard based on ED 4 is scheduled to be published in March 2004.

Project description	Overview	Timing/Status
Convergence: amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets	This is a short-term convergence project to modify the requirements for recognition of restructuring provisions to mirror the US requirements (SFAS 146 <i>Accounting for Costs Associated with Exit or Disposal Activities</i>). Generally, the proposals would require recognition of restructuring provisions at a later date than current practice under IFRSs.	An ED is planned for the second quarter of 2004.
Convergence: government grants (amendment of IAS 20 Accounting for Government Grants and Disclosure of Government Assistance)	In 2003 the IASB concluded that IAS 20 should be withdrawn and replaced with a new standard. In light of the International Financial Reporting Interpretations Committee's (IFRIC) work on emission rights it has decided to add a 'fast track' project to consider revising IAS 20 to require grants to be recognised as income when any conditions are met. The other options in IAS 20 would be removed.	An ED is expected in the second quarter of 2004.
Employee benefits	In December 2003, the Board added a fast track short-term project on employee benefits accounting. The principal change that will be proposed will be to permit immediate recognition of all actuarial gains and losses directly in equity. The IASB staff also is developing a plan for a long-term comprehensive project to look more fundamentally at accounting for employee benefits, possibly as a joint project with the US FASB and/or other national standard setters.	An ED for the fast track project tentatively is scheduled for the second quarter of 2004. However, the timing of this project currently is under review by the Board.
Exploration and evaluation activities	The proposals would permit entities to retain the accounting policies applied to their most recent annual financial statements for the recognition and measurement of exploration and evaluation assets until the IASB completes a longer-term comprehensive extractive industries project. A detailed overview of these proposals can be found in IASB <i>Briefing</i> Issue 16, February 2004.	ED 6 was issued on 15 January 2004. The comment period closes on 16 April 2004, and a final standard is scheduled to be issued late in 2004.
Financial instruments: amendments to IAS 39 (macro-hedging proposals)	The IASB finalised amendments to IAS 32 <i>Financial Instruments: Disclosure and Presentation</i> and IAS 39 <i>Financial Instruments: Recognition and Measurement</i> , in December 2003. A detailed overview of these amendments can be found in a special edition of IASB <i>Briefing</i> , Issue 15 January 2004. In finalising these amendments the IASB proposed new changes to permit a limited use of macro-hedging for interest rate risk. An overview of the macro-hedging proposals can be found in Attachment One to IASB <i>Briefing</i> Issue 14, November 2003.	An ED addressing macro-hedging was published in August 2003 with a 60-day comment period. The IASB published the amended IAS 32 and IAS 39 (exclusive of the new macro-hedging proposals) in December 2003. The revised IAS 39, including the amendments arising from the macro-hedging ED, will be published by the end of March 2004.
Financial instruments: fair value option	Regulators expressed concern about the potential misuse of the 'fair value option' included in amended IAS 39. The fair value option allows entities to make an irrevocable designation on initial recognition of any financial asset or financial liability, to measure that asset or liability at fair value with changes in fair value recognised in profit or loss. The Board discussed this issue in February 2004 and tentatively decided that it would limit the use of the option to specified situations.	An ED will be published in the second quarter of 2004.

Project description	Overview	Timing/Status
Financial risk and other amendments to financial instruments disclosures	This project covers all entities that have financial instruments. Its objective is to eliminate redundancies with other standards, and to revise and enhance existing disclosure requirements to mirror current IFRSs and business practices regarding financial risk management. It also will replace IAS 30 <i>Disclosures in the Financial Statements of Banks and Similar Financial Institutions</i> and certain financial risk disclosures currently required by IAS 32. The proposed changes are planned for annual periods beginning on or after 1 January 2007. Earlier adoption would be permitted.	An ED is scheduled for the second quarter of 2004 and a final standard in 2005.
Insurance contracts phase I	Phase I is designed as an interim step to facilitate adoption of IFRSs for insurance activities in 2005. The project establishes a definition of an insurance contract and addresses various recognition, measurement and disclosure issues. A detailed overview of the project can be found in IASB <i>Briefing</i> Issue 13, August 2003. During the Board's redeliberations it decided that a financial guarantee that met the definition of an insurance contract should be measured according to the requirements in IAS 39. The Board concluded that this decision required re-exposure.	ED 5 was published in July 2003. The comment period closed in October 2003 and a final IFRS is scheduled to be issued in March 2004. An ED discussing the proposed measurement model for financial guarantees that meet the definition of an insurance contract will be issued in the second quarter of 2004. Meanwhile the guidance in ED 5 for financial guarantees would be included in the final standard.
Insurance contracts phase II	This project seeks to develop further some of the issues identified in the 1999 Issues Paper <i>Insurance</i> . Any resulting standard would replace the standard resulting from Insurance contracts phase I. One possibility contemplated is an asset and liability model that requires identification and measurement of individual assets and liabilities arising from insurance contracts at fair value.	The project is expected to resume in May 2004 after completion of an IFRS based on ED 5. An ED resulting from this project is planned for June 2005.
Reporting performance	The project seeks to develop a single statement of comprehensive income. The focus is on separating initial recognition from remeasurement rather than seeking to define 'core earnings' or net income. In addition to replacing the traditional income statement, changes may be made to the statement of equity, the cash flow statement and possibly the balance sheet.	The Board conducted a sunset review of this project in October 2003. As a result the Board plans to issue a discussion paper as its next step, rather than moving directly to an ED.
Revenue recognition: concepts of revenue, liabilities and equity	This is a joint project with the US FASB to develop a comprehensive set of principles for revenue recognition to eliminate inconsistencies in practice.	The project is in its early stages with an ED scheduled for the fourth quarter of 2004.
Small and medium-sized entities	The Board is developing accounting standards appropriate for small and medium-sized entities (SMEs). The proposals are expected to be based on the basic principles of IFRSs, but with modifications to simplify reporting whilst meeting the needs of users of SMEs' financial statements. Disclosure and presentation requirements are likely to be modified; however the Board has indicated that recognition and measurement principles are unlikely to change unless they can be justified by users' needs and cost/benefit analysis.	As its next steps, the Board agreed to publish a discussion document setting out its tentative decisions on the approach to the project. Comments will be invited on the discussion document.

Mark your calendars ...

First Quarter 2004	Second Quarter 2004	Third Quarter 2004	Fourth Quarter 2004	2005
<ul style="list-style-type: none"> ■ Business combinations phase I final standard ■ <i>Disposals of Non-current Assets and Presentation of Discontinued Operations</i> final standard ■ Financial instruments: amendments to IAS 39 (including macro-hedging proposals) final standard ■ Insurance contracts phase I final standard ■ Comment period for D3 <i>Determining whether an Arrangement contains a Lease</i> and D4 <i>Decommissioning, Restoration and Environmental Rehabilitation Funds</i> closes on 19 March 2004 	<ul style="list-style-type: none"> ■ Business combinations phase I (mutual entities) ED ■ Business combinations phase II ED ■ Convergence: amendments to IAS 37 ED ■ Convergence: government grants (amendment of IAS 20) ED ■ Employee benefits (short-term project) ED ■ Financial instruments: fair value option ED ■ Financial risk and other amendments to financial instruments disclosures ED ■ Insurance contracts phase I (financial guarantees) ED ■ ED 6 comment period closes on 16 April 2004 	<ul style="list-style-type: none"> ■ Business combinations phase I (mutual entities) final standard 	<ul style="list-style-type: none"> ■ Consolidation and special purpose entities (SPEs) ED ■ Exploration and evaluation activities final standard ■ Revenue recognition: concepts of revenue, liabilities and equity ED 	<ul style="list-style-type: none"> ■ Insurance contracts phase II ED

- The timing of the reporting performance and employee benefits projects and accounting for small and medium-sized entities currently is under review by the Board.

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