IASB Update

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This presentation has been prepared to help constituents understand the current status of projects of the FASB and IASB. The views expressed in this presentation are those of the presenter. Official positions of the FASB and IASB are reached only after extensive due process and deliberations.

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Response to SEC Staff Report on IFRS

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No decision, not “No” decision

- Lack of commitment more a reflection of US political environment than IFRSs
  - SEC overwhelmed with Dodd-Frank rulemaking
  - Yet to appoint permanent successor to James Kroeker
- Little appetite for bold steps in tail end of current administration
- Very likely that real decisions will be left until at least post-election
- A definite role for the FASB, even when a decision is taken in favor of some sort of IFRS

Business as usual

- IASB remains focussed on working with FASB
- Four remaining convergence projects to complete
- IASB has other areas to attend to:
  - Development of research programme
  - New work plan
  - Development of new ways to work with standard setters and regulators

Preliminary comments on report

- Broadly in line with conclusions of Monitoring Board and Trustees' Governance and strategy reviews e.g.
  - Need for IASB to deepen cooperation with national standard setters
  - Need for more active interpretations committee
  - Improvement needed in consistency of global application of IFRSs
- Report predates important initiatives such as proposed revisions to IASB's *Due Process Handbook*

Preliminary comments (cont.)

- IFRSs perceived to be high quality by international financial reporting community
- “Substantial Support” for incorporation / endorsement approach
- Funding challenges more acute in US than elsewhere
  - Important to note that this is being addressed elsewhere in the world
  - SEC “committed to finding a solution to the US funding issue”

Moving forward

- Report reflects the many challenges faced by a large economy such as US in transitioning to IFRSs
- Political will required to overcome challenges of transition
- Many other large economies have successfully transitioned to IFRSs: Canada
- Commitment to implementation of global accounting standards by:
  - US Government
  - SEC
  - Repeated G20 communiqués

IFRSs: Critical Mass

- The momentum behind IFRS as the de facto global accounting standards is irreversible
- Most of the G20 Nations have already adopted
- IFRSs are now used by half of Fortune 500 companies

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Update on Financial Instruments

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Background

Phase	Title	Status
Phase I	Classification and Measurement	IFRS 9 *Financial Instruments* Financial assets completed in 2009 Financial liabilities completed in 2010
	Limited amendments to IFRS 9	Target exposure H2 2012
Phase II	Impairment	Target re-exposure H2 2012
Phase III	General hedge accounting	Review draft H2 2012 Final document end of 2012
	Accounting for macro hedging	DP H2 2012

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Phase I
Classification and Measurement - limited amendments to IFRS 9

Limited amendments to IFRS 9: Scope

Business model test

Contractual cash flow characteristics

Amortised cost (one impairment method)

FVOCI (one impairment method)

FVO for accounting mismatch (option)

All other instruments:
- Equities
- Derivatives
- Some hybrid contracts
- …

Fair Value (No impairment)

Equities: OCI presentation available (alternative)

Reclassification required if business model changes

Contractual cash flow characteristics assessment

Contractual cash flow characteristics

Contractual terms that give rise to solely payments of:

Principal

Interest

Interest = consideration for:

- time value of money
- credit risk

Tentative decision:
‘Modified’ P&I satisfies test IF compared with a ‘perfect’ instrument, difference not more than insignificant

Business model – tentative joint decisions

- Hold to collect → Amortised cost
- Hold to collect and sell → FVOCI (with recycling and impairment)
- Other (residual) → FVPL

Items confirmed in joint deliberations

- Tentative decisions
  - Bifurcation same as IFRS 9
    - No bifurcation of financial assets
    - ‘Closely related’ bifurcation of financial liabilities
    - No change to treatment of own credit
  - Reclassifications and FVO as per IFRS 9 but extended to include FVOCI category

Classification and Measurement - Next steps

- Joint discussions complete
- IASB tentatively decided to propose
  - from when final IFRS 9 is published those newly applying IFRS 9 must apply complete package
  - early application permitted
- Exposure drafts targeted fourth quarter 2012

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Phase II
Impairment

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General deterioration model

Scope: Financial assets that are *not credit-impaired* on initial recognition

On initial recognition

- Interest revenue calculated on gross carrying amount
- 12 months expected loss allowance

If

more than insignificant deterioration in credit quality AND

likelihood of loss event reasonably possible

- Interest revenue calculated on gross carrying amount
- Lifetime expected loss allowance

If deteriorate to credit-impaired

- Interest revenue calculated on the net carrying amount
- Lifetime expected loss allowance

Credit-impaired on initial recognition

- Scope
  - Both *originated* and *purchased* credit-impaired
  - Credit–impaired = same population as IAS 39 impaired *
- Always outside general deterioration model
- Use credit-adjusted effective interest rate
  - No day 1 allowance balance
  - No day 1 impairment loss recognised
- Allowance balance represents *changes* in lifetime loss expectations

* FASB will consider whether scope should be broadened.

Lease Receivables

- Lease receivables recognized as a result of the joint leases project:
  - An entity may choose to either:
    1) Fully apply “three-bucket” model, or
    2) Always recognize lifetime expected losses
  - Cash flows and discount rate used in the measurement of the lease receivables would be used as the contractual cash flows and effective interest rate for impairment purposes
- Lease receivables recognized by a lessor under existing leases guidance (Topic 840):
  - An entity may choose to either:
    1) Fully apply “three-bucket” model, or
    2) Always recognize lifetime expected losses

Trade Receivables

- Application of the model to trade receivables *with* and *without* a significant financing component as defined in Revenue Recognition 2011 Exposure Draft:
  - *With* a significant financial component, an entity may choose to either:
    1) Fully apply “three-bucket” model, or
    2) Always recognize lifetime expected losses
  - *Without* a significant financial component, an entity would always recognize lifetime expected losses

Three-Bucket Model – Initial U.S. Feedback

- FASB staff had received a number of questions regarding the principles in the model. Staff and the Board members performed outreach.
- FASB indicated its intention to develop application guidance to try and clarify the principles in the model.
- Purpose of the outreach was to understand
  - whether the model would be operable, auditable and understandable and
  - whether the draft application guidance sufficiently clarified the principles in the model.
- Root causes
  - “Transfer notion” lacks sufficient operational guidance
  - Bucket 1 measurement is confusing
  - Model doesn’t fix the PCI problem for preparers or users
- Resulting concern
  - May not result in consistent application
  - May not provide users with comparable or transparent results
  - Credit impairment allowance will be difficult for users to understand
  - Credit impairment allowance may not reflect the appropriate level of risk
- Re-exposure draft targeted Q4 2012

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Phase III
Hedge Accounting (General) and Macro Hedging

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Open topics and timeline- General Hedging

- All decisions have been taken
- No open topics

- Review draft (on website)
- Timing: mid 2012 (for ≈ 90 days)

- Issue as final (= part of IFRS 9)
- Timing: H2 2012

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Road map- Macro Hedging

- Continue with IFRS 9 as planned but *exclude* accounting for macro hedging from its scope
- Progress accounting for macro hedging as a separate project with the objective to prepare a Discussion Paper
- Interim solution:
  - Adopt IFRS 9 for all purposes except portfolio fair value hedge of interest rate risk (for which IAS 39 remains eligible)
  - Maintains status quo for those using macro hedge accounting

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Revenue from Contracts with Customers

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Agenda

- Project objective & status
- Overview of the revenue proposal
- Overview of feedback received
- Decisions to date & issues for future redeliberation
- Redeliberation plan
- Q&A

Project objective

Objective: To develop a single, principle-based revenue standard for US GAAP and IFRSs

- The revenue standard aims to improve accounting for contracts with customers by:
  - Providing a more robust framework for addressing revenue issues as they arise
  - Increasing comparability across industries and capital markets
  - Requiring better disclosure

Project status

2010

2011

2012

2013

June 2010

Exposure draft

Revenue from Contracts with Customers

974 comment letters

November 2011

Revised exposure draft

Re-exposure of *Revenue from Contracts with Customers*

358 comment letters

March 2012

Comment letter deadline

April 2012

Roundtables

May 2012 onwards

Redeliberations

H1 2013

Final standard (ASU / IFRS)

Retrospective transition proposed

Effective date to be determined (but no earlier than January 1, 2016)

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Overview of revised proposals

Core principle:

Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

Steps to apply the core principle:

1. Identify the contract(s) with the customer
2. Identify the separate performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognize revenue when a performance obligation is satisfied

Overview of feedback

Project objective and proposals are generally supported, but…

- Requests to clarify and refine the proposals
  - Identifying separate performance obligations
  - Determining revenue over time
- Difficulties in practically applying proposals
  - Time value of money
  - Retrospective transition
- Disagreement
  - Disclosure requirements
  - Onerous performance obligations
  - Application to the telecommunications industry

Step 1: Identify the contract(s)

- Planned for discussion in September 2012

Proposal	Issues for redeliberation include
Combine contracts with the same customer and entered into at or near the same time if specified criteria are met	Accounting for contracts that are economically linked (e.g., sales through a distribution channel with promises to an ultimate customer)
Contract modifications • Some accounted for as a separate contract • Otherwise, re-evaluate remaining performance obligations	Clarify and reduce complexity of the proposed requirements

Step 2: Identify the separate performance obligation(s)

- A promise to transfer a good or service (or a bundle of goods or services) is a separate performance obligation only if the promised good or service is:
  - capable of being distinct—the customer can benefit from the good or service on its own or together with other readily available resources; and
  - distinct within the context of the contract—the good or service is not highly dependent on, or highly interrelated with, other promised goods or services in the contract
- Indicators that a good or service is distinct within context of the contract

Entity does not provide a significant service of integrating the good or service into a combined item (inputs to produce an output)	The good or service does not significantly modify or customise other promised goods or services	Purchasing (or not purchasing) the good or service would not significantly affect the remainder of the contract	The good or service is not part of a series of consecutively delivered goods or services accounted for as performance obligations satisfied over time with a single measure of progress

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Step 3: Determine the transaction price

- Planned for discussion in September 2012

Proposal	Issues for redeliberation include

Account for time value of money only if there is a significant financing component that is significant to the contract	• Clarify when a contract has a significant financing component
	  • relevance of primary intent of payment terms
	  • 1 year practical expedient
	• Application to advance payments
	• Practical difficulties (e.g., multiple performance obligations, variable consideration)

Effects of customer credit risk excluded from revenue but presented adjacent to revenue line on income statement	• Presentation of impairment loss • Accounting for subsequent impairments • Linkage with accounting for receivables and contracts with significant financing components • Need for a minimum recognition threshold?

Step 4: Allocate the transaction price

- Planned for discussion in October 2012

Proposal	Issues for redeliberation include
The transaction price should be allocated to each separate performance obligation on a relative standalone selling price basis • Estimate selling prices if they are not observable • Residual estimation techniques may be appropriate	Application of the residual approach to estimate stand-alone selling prices (e.g., mobile phone handsets sold as part of a bundled arrangement or software contracts whereby two or more of the promised goods or services have highly variable or uncertain stand-alone selling prices)
Discounts and contingent amounts are allocated entirely to one performance obligation if specified criteria are met	Consider the basis for allocating discounts or variable consideration

Overview of Step 5: Recognize revenue

Revenue is recognized when (or as) the entity satisfies a performance obligation by transferring a promised good or service to the customer

Performance obligations satisfied over time

A performance obligation is satisfied over time if the criteria in paragraph 35 are met (see following slide)

Revenue is recognized by measuring progress towards complete satisfaction of the performance obligation

Performance obligations satisfied at a point in time

All other performance obligations are satisfied at a point in time

Revenue is recognized at the point in time when the customer obtains control of the promised asset. Indicators of control include:

- Present right to payment
- Legal title
- Physical possession
- Risks and rewards of ownership
- Customer acceptance

Step 5: Recognize revenue

- An entity satisfies a performance obligation and recognizes revenue over time if one of the following criteria are met:
  a. the customer receives and consumes the benefits of the entity's performance as the entity performs
     - an objective basis for assessing benefit—hypothetically, would another entity need to substantially re-perform the work the entity has completed to date if that other entity were to fulfil the remaining obligation to the customer?
  b. the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced
  c. the entity's performance does not create an asset with an alternative use to the entity and the entity has a right to payment for performance completed to date and it expects to fulfil the contract as promised

Step 5: Constraint on the cumulative amount of revenue recognized

- Planned for discussion in September 2012

Proposal	Issues for redeliberation include
When consideration is variable, the cumulative amount of revenue recognized is limited to the amount to which an entity is reasonably assured to be entitled An entity is reasonably assured if: • it has experience with similar types of performance obligations • its experience is predictive of the amount of consideration to which the entity will be entitled Various factors might indicate that the entity's experience is not predictive	• Clarify meaning of 'predictive experience' • Clarify principles to address royalties (paragraph 85)

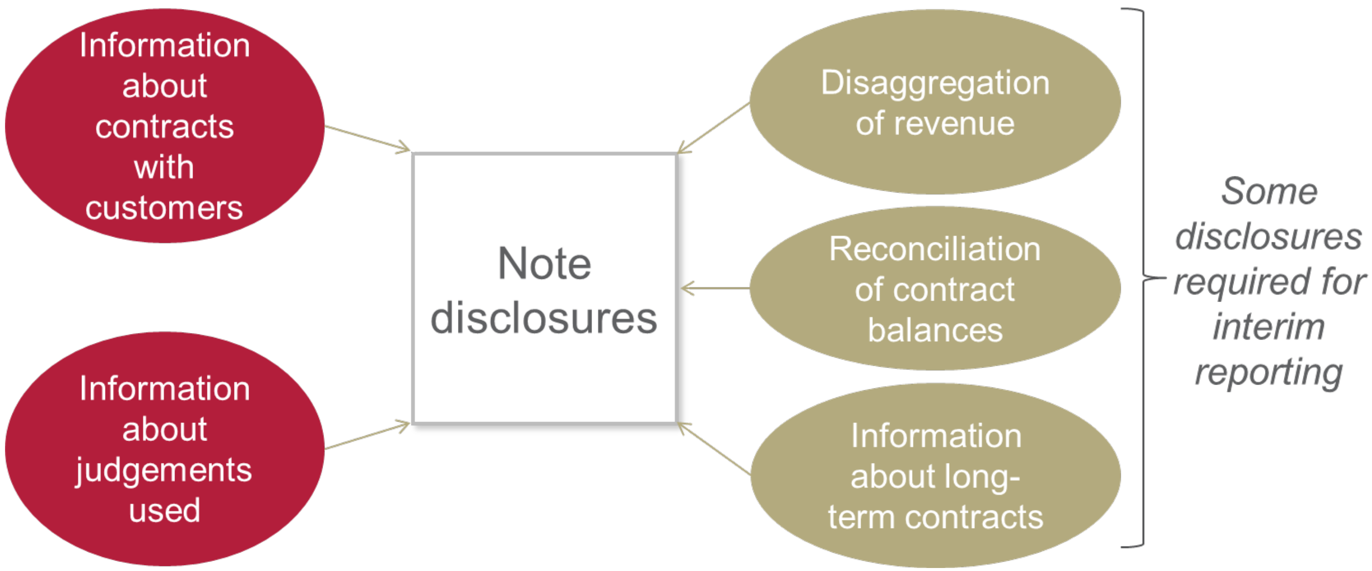
Onerous performance obligations

- The revenue standard will not include an onerous test
- Instead, an entity will apply the onerous tests in existing IFRSs or US GAAP

IFRSs	Requirements in IAS 37 for onerous contracts would apply to all contracts with customers
US GAAP	Existing guidance for recognition of losses will be retained, including guidance in Subtopic 605-35 for losses on construction and production contracts

Disclosure

- Planned for discussion in November 2012



- Redeliberations to consider costs and benefits of annual and interim disclosures
  - Users—level of disclosure is appropriate (or more is required)
  - Preparers and others—disclosure proposals are excessive, overly prescriptive and requires information not used by management

Revenue and leases

- Scope
  - leases standard applies to determine whether a contract with a customer includes a lease
  - revenue standard applies to services separate from lease
- Accounting for variable consideration
- Pattern of revenue recognition:
  - revenue model—revenue recognized when performance obligations are satisfied
  - leases model—revenue recognition model based on the level of consumption of the underlying asset
- Redeliberations on licences and rights to use IP will continue in September 2012

Other planned redeliberation topics

MONTH	REDELIBERATION TOPIC
July 2012 (Complete)	• Identification of separate performance obligations (Step 2) • Satisfaction of performance obligations (Step 5) • Onerous test
September 2012	• Constraint (Step 5) • Collectibility • Time Value of Money (Step 3) • Contract Issues (Step 1) • Licenses • Measures of Progress (Step 5)
October 2012	• Scope • Costs • Allocation of the transaction price (Step 4) • Nonfinancial assets
November 2012	• Disclosures • Transition, effective date & early adoption
December 2012	• Sweep issues & consequential amendments • Cost-benefit analysis

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Leases

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Leases

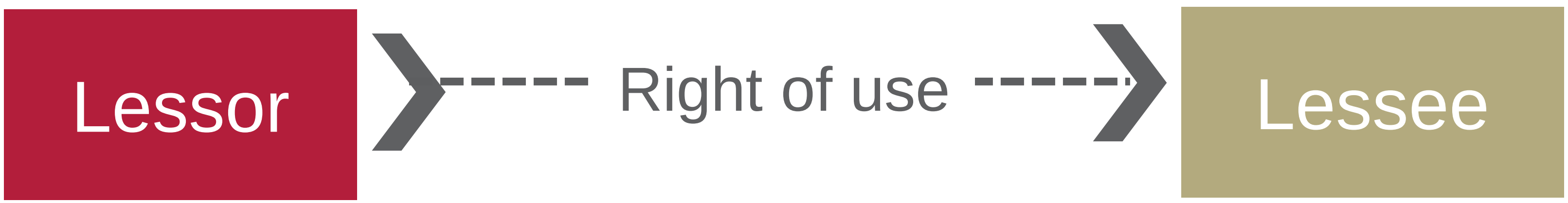
- Why a leases project?
- Right-of-use model
- Lessee accounting model
- Lessor accounting model
- Classification of leases
- Where we are

Why a leases project?

- Existing lease accounting does not meet users' needs
  - – accounting depends on classification
  - – contractual rights and obligations (assets and liabilities) are off balance sheet
  - – many users adjust financial statements
- Structuring opportunities
  - – current lease classification often based on bright lines
  - – significant difference in accounting on either side of operating/finance lease line

Proposed right-of-use model

- A lease contract is one in which the right to control the use of an asset (for a period of time) is transferred to the lessee.



2010 ED proposals for Lessees

- Lessee obtains the right to use an asset and has an obligation to pay for that right

Balance Sheet		Income Statement	
Right-of-use asset	X	Amortization expense	X
Liability to make lease payments[1]	X	Interest expense	X

[1]Discount at rate lessor charges the lessee or lessee's incremental borrowing rate if lessor rate not available.

Lessee Feedback received

Main Themes

General support for recognition of assets and liabilities

Concerns about cost and complexity

Mixed views on income statement effects

Concerns about service contracts being captured as leases

Redeliberations—lessee model

Balance sheet

Income statement

DR ROU asset [2]
CR Lease liability[1]

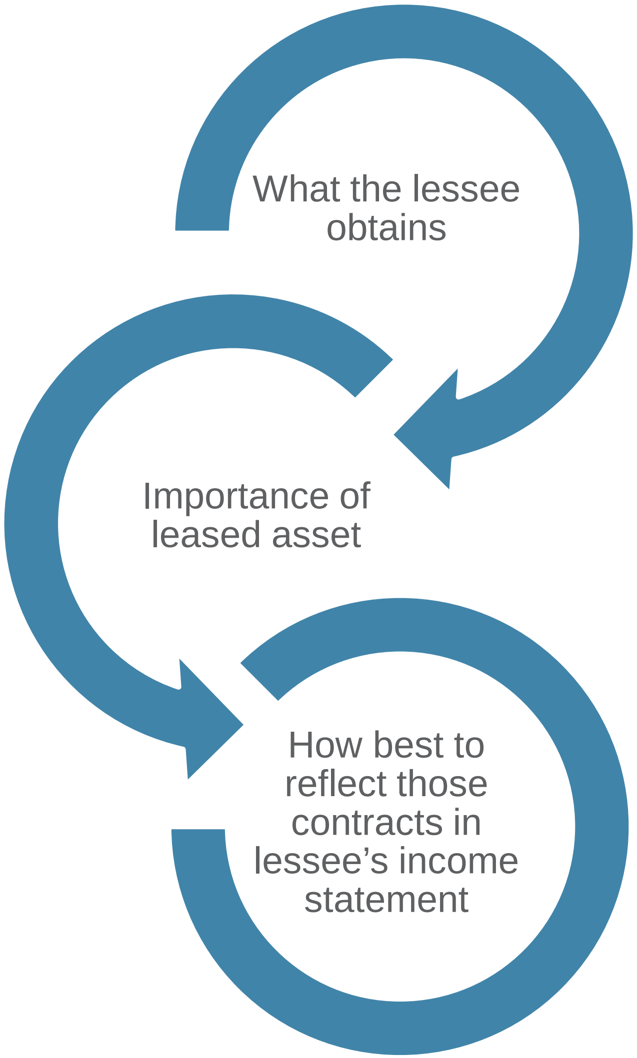
Lessee consumes more than insignificant portion of leased asset → Amortization expense, Interest expense

Lessee does not consume more than insignificant portion of leased asset → Lease expense

[1] Measured at present value of lease payments

[2] Initially measured at same amount as liability, plus initial direct costs

The rationale (lessee)



- Right to use an asset
- Obligation to pay for that right

- Not all leases are the same
  - 10-year airplane lease => paying to acquire the piece of the airplane consumed plus financing
  - 3-year real estate lease => paying only for use of the lessor's asset

- Recognize amortization on ROU asset (and interest on lease liability) when lessee consumes a more than insignificant portion of leased asset
- Recognize straight-line lease expense when lessee is paying only for use of the lessor's asset

Reducing complexity and cost

Lessee and Lessor

	2010 ED	Post-ED simplifications
Options to extend the lease term (term options)	• Longest possible lease term more likely than not to occur • Reassessed	• Option period included if lessee has significant economic incentive to exercise • Reassessed other than for market conditions
Variable lease payments	• Included in lease liability on probability-weighted basis • Reassessed	• Excluded from liability (unless in-substance fixed or based on an index or rate) and accounted for as occurred • Reassessed for spot/index
Short–term leases (lease term ≤ 12 months)	• Liability/asset recognized with no discounting	• No liability/asset recognized • Rent expense • IAS 17 operating lease model

Redeliberations – definition of a lease

Lessee and Lessor

- ‘Contract in which the right to use an asset is conveyed, for a period of time, in exchange for consideration’
  - underlying asset = identifiable (physically distinct)
  - right to control use of underlying asset
- Notion of control changed
  - ‘ability to direct the use’ and receive benefits
  - change from EITF 01-8/IFRIC 4/ED:
    - if entity obtains substantially all output ≠ control
    - pricing does not determine control

Lessee Redeliberations

Other Issues

- Multi-element contracts
  - separately account for non-lease elements
  - allocate between lease and non-lease elements if there are observable prices
- Lessee residual value guarantees
  - include in lease payments amounts expected to be payable
- Sale and leaseback transactions
  - if sale, account for as sale then leaseback

2010 ED – Lessor accounting

Does the lessor retain significant risks or benefits of the underlying asset?

No

Derecognition approach:

- Derecognize underlying asset
- Recognize residual asset
- Profit on amount derecognized and interest income

Yes

Performance obligation approach:

- Recognize underlying asset
- Recognize performance obligation
- Lease income, depreciation and interest income

Both approaches: recognize lease receivable

Lessor Feedback received

Main Themes

Concerns about lessor model:
- relationship with lessee model
- not representing economics
- little support for PO approach

Concerns about cost and complexity

Concerns about service contracts being captured as leases

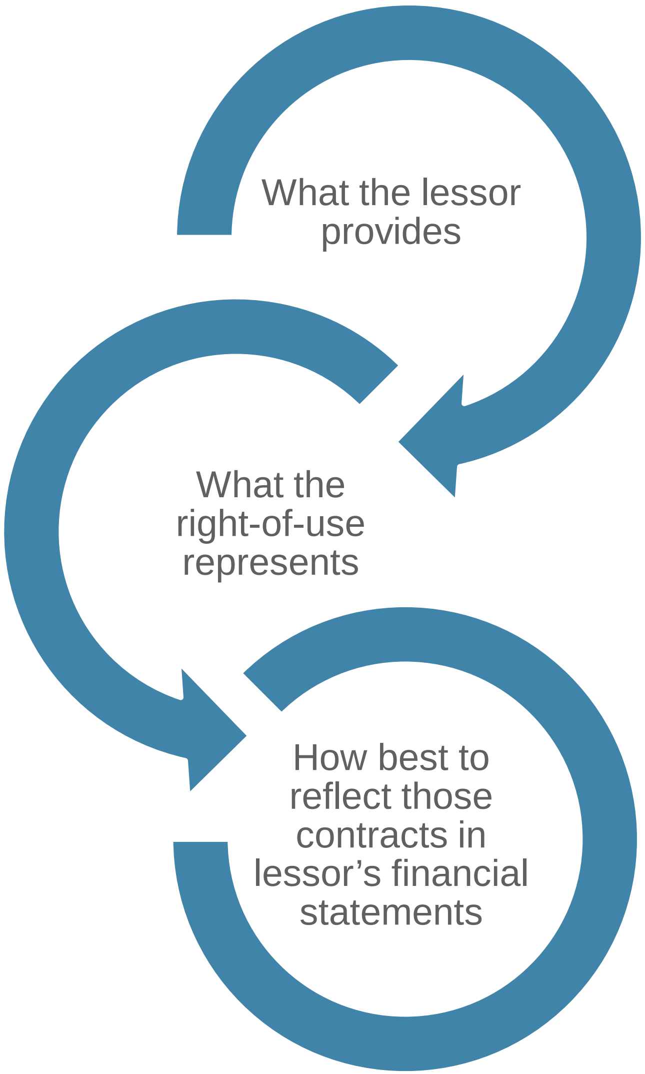
Redeliberations—lessor model

Lessor accounting approach

Asset subject to lease

- Lessee consumes more than insignificant portion of leased asset → Receivable and residual approach
- Lessee does not consume more than insignificant portion of leased asset → Approach similar to current operating lease accounting

The rationale (lessor)



- Lessor provides the lessee with the right to use an asset
- Not all leases are the same
  - 10-year airplane lease => lessor charges the lessee to recover expected consumption of the airplane plus financing
  - 3-year real estate lease => lessor charges the lessee only for use of the real estate
- Recognize lease receivable and retained interest in residual asset when lessee consumes a more than insignificant portion of leased asset
- No change to accounting for leased asset and recognize straight-line lease income when lessor charges the lessee only for use of the leased asset

Receivable and residual approach

Balance Sheet		Income Statement	
Right to receive lease payments[1]	X	Profit on transfer of right-of-use (gross or net based on business model)	X
Residual asset[2]	X	Interest income—on receivable and residual[3]	X

[1] Present value of lease payments, plus initial direct costs
[2] Measured at an allocation of carrying amount of leased asset
[3] Interest on residual based on estimated residual value—any profit on the residual asset is not recognized until asset sold or re-leased at end of lease term

Lessor approach similar to current operating lease accounting

Balance Sheet		Income Statement	
Leased asset[1]	X	Rental income[2]	X
		Depreciation[3]	(X)

[1] Lessor measures leased asset (e.g. property) at cost

[2] Rental income recognized on a straight-line basis or another systematic basis, if more representative of pattern of earning rentals

[3] Asset depreciation recognized

Classification of leases*

Lessee consumes more than insignificant portion of leased asset

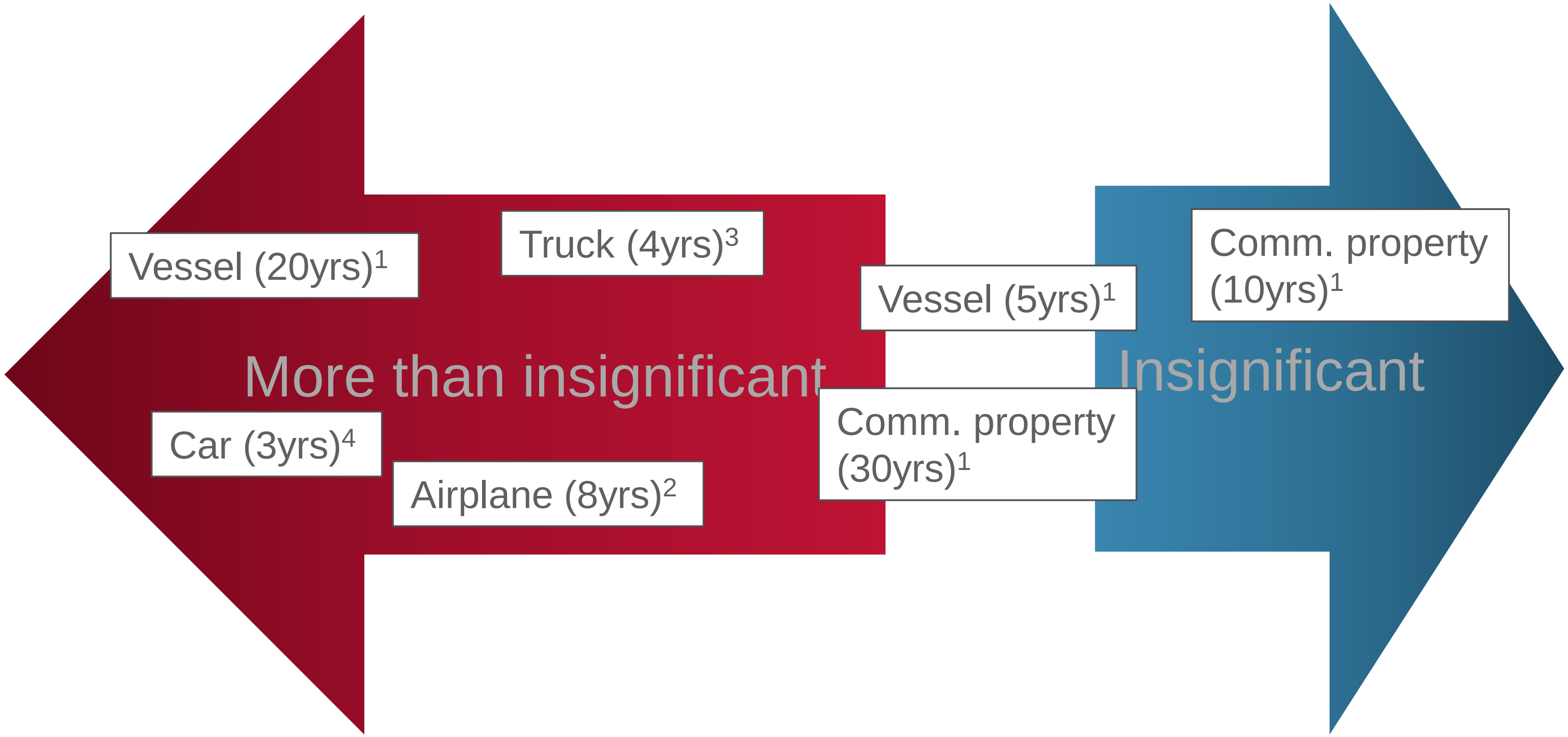
- Leases of assets other than property *unless*:
  - Lease term is insignificant relative to economic life of asset
  - PV of lease payments is insignificant relative to FV of asset

Lessee does not consume more than insignificant portion of leased asset

- Leases of property (land and/or a building) *unless*:
  - Lease term is major part of economic life of asset
  - PV of lease payments is substantially all of FV of asset

* Both lessee and lessor

Classification of leases—examples



Assumed economic life of:

[1] 40 years

[2] 25 years

[3] 10 years

[4] 6 years

Leases - Where we are

2010

August 2010
Exposure Draft
Leases

Comment period 4 months

786 comment letters received

Contained proposals for both lessees and lessors

2012

Q4 2012
Second Exposure Draft
Leases

Re-expose proposals

Comment period 120 days

Focus on revisions to 2010 proposals

Will contain proposals for both lessees and lessors

2012/ 2013

Consultation

Outreach

Working group meetings

Redeliberations

TBD

TBD
Final Standard
Leases

Effective date: TBD
Will contain guidance for both lessees and lessors

Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenters. Official position of the IASB on accounting matters are determined only after extensive due process and deliberation.