IASB-FASB Update Report to the FSB Plenary on Accounting Convergence

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Summary

1. In 2006 the IASB and the FASB (the boards) agreed on a Memorandum of Understanding (MoU) that identified the short-term and longer-term convergence projects that would bring the most significant improvements to IFRSs and US GAAP. The MoU was updated in 2008.
2. The boards are close to completing the MoU programme:
   - Most of the short-term projects identified for action have been completed or are close to completion and one has been determined to be a lower priority.
   - Of the longer-term projects, several have been completed and there are three of the originally identified projects for which the boards have yet to finalise the technical decisions—leases, revenue recognition and financial instruments.
3. In our previous report we indicated that neither board would issue a new standard until it had first considered whether re-exposure was necessary; secondly, that it had considered the feedback on the proposed final standard; and thirdly, that it was satisfied that the standards were operational. In mid-2011, the boards jointly announced that they had decided to re-expose both the revenue recognition and leases proposals. This decision was made in response to feedback from a broad range of global constituents who raised concerns about the significant impact these standards would have on financial reporting. While formal decisions have not been made by the boards on classification and measurement and impairment of financial instruments, taking into consideration the significance of the changes that these projects propose, we expect that they will also be re-exposed.
4. The IASB and the FASB are continuing to work expeditiously on reaching converged

solutions on our financial instruments, leases, and insurance projects. However, that work is being undertaken at a pace that enables thorough consultation to be undertaken with a particular focus on ensuring that potential solutions are operational. We expect that we will begin redeliberations of our joint project on revenue in the second quarter of 2012 and that we will re-expose our projects on classification and measurement, impairment and leases in the second half of 2012. We expect to issue final standards on these projects by mid- 2013.

5. Delays in completing these much-needed improvements to financial reporting are unfortunate, but necessary to ensure that any changes are operational and will bring about an improvement to financial reporting in these important areas. It is incumbent on the boards to ensure that changes made to our accounting requirements are appropriate, that our stakeholders have had the opportunity to fully participate in the process, and that the boards have been responsive in considering stakeholder feedback in the process. Re-exposure, in this case, is part of that process.

Update

6. The boards are continuing their efforts to achieve a single set of high quality, global accounting standards, within the context of an independent standard-setting process.

7. The MoU identified the short-term and longer-term projects that the boards agreed would bring the most significant improvements to IFRSs and US GAAP.

8. In 2010, with the support of the international community, the boards set priorities for the projects that would make the most significant improvements to IFRSs and US GAAP.

Short-term projects

9. Most of the short-term projects required one of the boards to revise its requirements to better align them with those of the other board—eg the IASB revised segment reporting to align it with US GAAP. Other projects, such as share-based payments, required both boards to issue revised standards.

Project	Status	Milestone
Share-based payments	Completed	Converged standards issued in 2004.
Segment reporting	Completed	IFRS 8 *Segment Reporting* issued in 2006.
Non-monetary assets	Completed	The FASB converged the treatment of certain nonmonetary exchanges to require recognition at fair value unless the transaction lacks commercial substance in FAS 153, *Nonmonetary Assets* issued in 2004.
Inventory accounting	Completed	The FASB converged the treatment of excess freight and spoilage in FAS 151, *Inventory Costs* issued in 2004.
Accounting changes	Completed	The FASB converged the treatment of voluntary changes in accounting policy by requiring retrospective application in FAS 150, *Accounting Changes and Error Corrections* issued in 2005.
Fair value option	Completed	Fair value option for financial instruments introduced into US GAAP in 2007.
Borrowing costs	Completed	Revised IAS 23 *Borrowing Costs* in 2007.
Research and development	Completed	US GAAP amended for acquired R&D, as part of business combinations, in 2008.
Non-controlling interests	Completed	Mezzanine presentation eliminated from US GAAP, as part of business combinations, in 2008.
Joint ventures	Completed	IFRS 11 *Joint Arrangements* issued in May 2011. Establishes principles for the financial reporting by parties to a joint arrangement.
Income tax	Reassessed as a lower priority project. No immediate action.	Joint exposure draft published in 2009. The IASB may consider a fundamental review of the accounting for income taxes at a later date.
Investment property entities	In process	The FASB issued a proposal to require investment property entities to measure their investment properties at fair value.

Long-term projects

10. The MoU was updated in 2008, at which time the boards narrowed down the programme to focus on ten longer-term projects. The boards have worked successfully to complete most of the projects in the updated 2008 MoU:

	Project	Status	Milestone
1	**Business combinations**	Completed	Joint requirements for business combination accounting and non-controlling interests issued in 2008.
2	**Derecognition**	Completed	Each board has introduced reforms substantially aligning the disclosure requirements and bringing US GAAP accounting requirements closer to IFRSs.
3	**Consolidated financial statements** (including disclosure about off balance sheet risks)	Completed	IFRS 10 *Consolidated Financial Statements* and IFRS 12 *Disclosure of Interests in Other Entities* issued in May 2011. The FASB issued proposed clarification relating to principals vs. agents in 2011.
4	**Fair value measurement**	Completed	FASB Statement No. 157 *Fair Value Measurements* issued in 2006. IFRS 13 *Fair Value Measurement* issued in May 2011.
5	**Post-employment benefits**	Completed	Amendments to IAS 19 *Employee Benefits* issued in 2011.
6	**Financial statement presentation—other comprehensive income**	Completed	Amendments to IFRSs and US GAAP for presentation of other comprehensive income issued in 2011.
7	**Financial instruments with the characteristics of equity**	Reassessed as a lower priority project.	Joint discussion paper published in 2008.
8	**Investment entities**	IASB and FASB published proposals in August and October 2011, respectively. .	The IASB's proposal would exempt a class of entities whose substantive activity is investing for capital appreciation, investment income, or both from consolidating entities they control. Instead, these investment entities would measure controlled investees at fair value, with any changes in fair value recognised in profit or loss. The FASB's proposal would amend the existing guidance in US GAAP for investment companies to develop converged criteria for assessing whether an entity is an investment company.

11. Today there are only three longer-term priority MoU projects for which the boards have yet to finalise all of the technical decisions—**Financial instruments**, **Revenue recognition** and **Leases**. The timelines on revenue recognition and leases were extended at the request of many stakeholders to ensure that their interests could be given full consideration. Although the MoU projects have been

given priority, the boards have also been working together on much-needed improvements to the accounting for **Insurance contracts**.

	Project	Status	Milestone
1	**Leases**	In process	Having exposed joint proposals in August 2010, the boards plan to publish revised proposals in the second half of 2012 that respond to the extensive consultation undertaken.
2	**Revenue recognition**	In process	The boards exposed joint proposals in June 2010. The comment period for the revised proposals that respond to the extensive consultation undertaken closed in March 2012. The boards expect to complete their discussions in 2012.
3	**Financial instruments**	In process	Described in the financial instruments section of this document.
4	**Insurance contracts**	In process	The boards are working towards their next publications for the second half of 2012. The IASB is considering whether it should publish another exposure draft (ED). Doing so would align the boards' consultative processes because the FASB has yet to publish an ED.

Status of the work plan

12. The IASB and FASB remain committed to completing the remaining three MoU projects—financial instruments, revenue recognition and leases—as well as insurance contracts, as expeditiously as possible.

13. The next sections of this report describe in more detail the status of the individual projects and the steps that the boards plan to take to complete the MoU programme.

Financial instruments

Classification and measurement

IASB

14. The IASB completed the classification and measurement chapters of IFRS 9 *Financial Instruments* in 2009 for financial assets and in 2010 for financial liabilities. IFRS 9 has resulted in simplifying the classification and measurement model for financial assets to two categories (amortised cost and fair value) with a single impairment model. Tainting rules are eliminated and embedded derivatives are no longer required to be separated from their financial asset host contract.

15. The volatility in profit or loss resulting from fair value measurement of a company's own debt is addressed by requiring such gains and losses to be recorded within Other Comprehensive Income (OCI).

16. In December 2011, consistently with its commitment to ensure that entities are able to apply all phases of IFRS 9 simultaneously, the IASB deferred the mandatory date of IFRS 9 from 2013 to 2015. Early adoption is still permitted.

FASB

17. In 2010 the FASB published an exposure draft addressing the classification and measurement of financial instruments, impairment accounting and hedge accounting. The FASB's exposure draft proposed a much greater use of fair value measurement than does IFRS 9, with almost all financial instruments on the balance sheet at fair value. The proposal included an amortised cost option for certain financial liabilities.

18. Responding to the feedback received on the exposure draft, the FASB tentatively decided that at least some assets should qualify for amortised cost accounting, based on the business activity the entity uses to manage those financial assets. The FASB has tentatively decided that three different business strategies are relevant to the classification of financial assets and have tentatively decided that bifurcation of financial instruments should be retained. The FASB also tentatively decided that financial liabilities would be measured at amortised cost

unless the business strategy for the financial liability at acquisition, issuance, or inception is to subsequently transact at fair value, or to sell in a short sale. Those financial liabilities would be classified at fair value through net income.

NEXT STEPS

19. As noted above, the boards have reached different answers on matters such as the number of classification categories, which assets should be measured at fair value, where fair value changes should be recognised and the bifurcation of embedded derivatives. In addition, there are important legacy differences, such as whether items measured through other comprehensive income should be recycled to net income when they are sold.

20. The IASB and the FASB have consistently received feedback from stakeholders to the effect that every effort should be made to make their respective financial instruments accounting standards converge. In November 2011 the IASB agreed to consider modifying IFRS 9, particularly in view of convergence and the insurance contracts project. The IASB noted that any changes should be made in a manner that minimises disruption for those who have already started to apply or were close to applying IFRS 9.

21. At the January 2012 joint meeting, the IASB and the FASB agreed to jointly consider ways in which their models could be better aligned. The boards are planning to discuss key areas of differences over a series of public board meetings through the second quarter 2012.

22. The boards will focus on discussing: which instruments are eligible for amortised cost (ie contractual cash flow characteristics and business model criteria); the need for bifurcation of financial assets, and, if pursued, the basis for bifurcation; the basis for and scope of a possible third classification category (debt instruments measured at fair value through other comprehensive income); and any knock-on effects (for example, disclosures or the model for financial liabilities given the financial asset decisions).

23. At the February 2012 meeting the boards tentatively agreed to the same contractual cash flows test, which removed a significant difference between their models.

24. The boards are continuing their deliberations and expect to be in a position to issue exposure drafts in the second half of 2012, and to finalise new standards in the first half of 2013. Owing to the different stages of development, the boards propose that any exposure drafts should be separate but achieve as converged an outcome as possible.

25. In addition, in response to significant investor feedback, the FASB has proposed several new disclosures requirements: sensitivity analysis, information about liquidity, asset/liability mismatches, etc. These requirements are based on IFRS 7 *Financial Instruments: Disclosures*, but are more expansive, and would require standardised formats. The FASB plans to expose them separately in the second quarter of 2012, before the classification and measurement changes.

Impairment

26. The IASB and the FASB are continuing to address the main criticism of an incurred loss impairment model that was highlighted during the financial crisis. The boards are jointly developing a more forward-looking 'expected loss' approach to impairment (also known as loan loss provisioning). The IASB published an initial exposure draft of proposals in 2009. The FASB's 2010 exposure draft on financial instruments proposed a different expected loss model. Stakeholders responded that reaching a common impairment solution is very important. The IASB and the FASB subsequently published supplementary joint proposals in 2011 and continue to jointly develop a common impairment model.

27. The boards are pursuing a model with an overall objective of reflecting the deterioration in the credit quality of financial assets. The boards have focused on an approach that places financial assets into three categories (or 'buckets') for the purpose of assessing the timing of recognition of expected losses. The impairment loss recognised would vary depending on which category an asset is allocated to. Generally, 12 months of expected losses are recognised on initial

recognition. If an asset deteriorates in credit quality and the credit quality is below a certain level, the asset would be reclassified to another category and a lifetime loss allowance would be recognised. Disclosures will be critical to support the principle-based impairment model and ensure comparability between entities.

28. The boards and staff continue to perform extensive joint outreach to determine whether the proposed approach is operational. The boards are discussing how the proposed model would apply to certain financial instruments and what disclosures should be required. The boards have been consulting widely with, among others, prudential supervisors and members of the IASB's Expert Advisory Panel of credit risk experts who provide guidance on the operational considerations of the proposals.

29. Reaching a converged solution is of the utmost importance. The boards have had to balance the urgency of the project with the need to ensure that any new requirements are operational, will be applied consistently and will produce high quality information. The broad consultation has shown that current practices diverge widely and that any solution will cause significant changes for at least some major participants in the financial sector.

30. The current plan is to complete joint deliberations and issue converged exposure drafts in the second half of 2012. On the basis of that timetable, we would target finalisation of the new impairment requirements to be achieved in the first half of 2013.

Hedge accounting

General hedge accounting

31. The boards had differences in scope in their original hedge accounting projects. The IASB proposed a fundamental overhaul of hedge accounting to tie in with risk management and make hedge accounting more accessible for corporates (non-financial institutions). The FASB had a more focused approach dealing with narrower practice issues in their hedge accounting requirements. Because of the scope differences, the boards originally decided to work separately, with the

FASB inviting its constituents to comment on the IASB's document as well as its own.

32. The IASB published its exposure draft in 2010. In 2011, the IASB completed its redeliberations on its exposure draft. A review draft will be posted on the IASB's website for 90 days in the first half of 2012, during which time the IASB will undertake an extended fatal flaw review and outreach activities. The IASB is targeting a final standard to be issued in the second half of 2012.

33. The FASB plans to consider whether to expand its evaluation of hedge accounting issues. The FASB will begin redeliberations on the hedge accounting model once the deliberations on classification and measurement are complete, to ensure that the interaction of these decisions on a potential hedge accounting model is clear. As part of this process, the FASB will continue to evaluate the feedback received on the FASB's 2010 exposure of its hedge accounting proposals and the feedback and decisions reached on the IASB's general hedge model.

Macro hedge accounting

34. The IASB is currently developing proposals to address risk management strategies involving open portfolios (macro hedging) that are not dealt with by the general hedge accounting model. The IASB's deliberations consider the feedback received on the general hedge accounting model. The IASB expects to publish a discussion paper or an exposure draft of proposals in the second half of 2012.

Offsetting (netting) derivatives and other financial instruments

35. In response to stakeholders' concerns (including those of the Basel Committee on Banking Supervision and the Financial Stability Board) regarding the comparability of entities using IFRSs and US GAAP, the IASB and FASB decided to expand the scope of the joint project on financial instruments to address netting or offsetting financial assets and financial liabilities on the statement of financial position (balance sheet). Offsetting (or netting) requirements are the source of significant differences between the balance sheets

of financial institutions using US GAAP and those using IFRSs. A common solution would be of great assistance to regulators and other users of financial statements.

36. In early 2011, the boards published proposals to align their requirements for when financial assets and financial liabilities are set off, or netted, in the statement of financial position. The proposed model focused on netting on the basis of the ability and intention to offset payments in the normal course of business and in times of stress. This was closer to the requirements in IFRSs than to US GAAP, which, for derivatives, gives primacy to the ability to offset in bankruptcy.

37. In June 2011 the IASB and FASB reached different conclusions. The FASB decided not to proceed as proposed based on the feedback that they received on the proposals. The IASB initially reaffirmed the proposals in the exposure draft but ultimately decided to maintain its existing offsetting requirements. However, to assist users of financial statements, the boards agreed on common disclosure requirements. These disclosures will provide users with comparable information on amounts that are offset and subject to offsetting arrangements for financial statements prepared in accordance with IFRSs and US GAAP.

38. The boards issued final requirements in December 2011. These requirements are effective for periods beginning 1 January 2013.

39. In addition, in December 2011 the IASB issued additional application guidance to IAS 32 *Financial Instruments: Presentation*, to clarify inconsistencies in offsetting practice that were identified during the comment period.

Accounting for Repurchase Agreements (FASB)

40. In March 2012, the FASB formally announced a project to address the accounting for repurchase agreements. Among the issues that the new project will consider is whether repo-to-maturity transactions should be reflected on the balance sheet as financings instead of being treated as off-balance sheet sales and whether enhanced disclosures are necessary. Under IFRS 9, repo-to-maturity transactions are generally accounted for as secured borrowings.

Revenue recognition

41. As we previously stated in our report to you in October 2011, after considering the feedback they had received on the exposure draft, the boards decided to re-expose their revised proposals. It was the unanimous view of the boards that, while there was no formal due process requirement to re-expose the proposals, it was appropriate to go beyond established due process, given the importance of the revenue number to all companies and the need to take all possible steps to avoid unintended consequences. Consequently, the boards have now issued three due process documents: a discussion paper in December 2008, an exposure draft in June 2010 and a revised exposure draft in November 2011.

42. The project is critical to both the FASB and the IASB. US GAAP has a wide range of industry-specific requirements that are acknowledged to be inconsistent. The IASB's standard does not have any application guidance and preparers often look to US GAAP for specific guidance. The project is intended to reduce the FASB's detailed guidance to consistent principles and to remove the need for IFRS users to refer to US GAAP.

43. In November 2011 the boards issued a revised exposure draft with a comprehensive principle and application guidance for when and how to recognise revenue. The revised exposure draft reaffirms the principle for revenue recognition from the first exposure draft (issued June 2010) but, in response to the feedback received, amends the proposals to reduce complexity and add clarity to the basic concepts. The 120-day comment period ended in March 2012.

44. The boards have taken a number of steps to inform stakeholders about the revised proposals. The IASB's and the FASB's websites contain a webcast explaining the major provisions, a webcast answering frequently asked questions, and a reference tool comparing current requirements with the proposed requirements and highlighting the industries that would be affected. Extensive outreach has been undertaken with stakeholders around the globe to help them understand the proposal and formulate their views. Round-table meetings and discussion forums will take place in the second quarter of 2012 in Europe, North America, Asia and South America.

45. The boards expect to begin joint redeliberations in the second quarter of 2012. Substantive deliberations are expected to be completed in 2012 with a final standard expected to be issued in early 2013.

Leases

46. Lease obligations are widely considered to be a significant source of off balance sheet financing. The objective of this project is to improve financial reporting by ensuring that all assets and liabilities arising from lease contracts are recognised in the statement of financial position.

47. In August 2010, the boards issued an exposure draft proposing that the rights and obligations relating to leases should be reported on a lessee's balance sheet. The proposed accounting for lessors was designed to ensure that an entity that retains significant risks or benefits of the leased asset would recognise that asset and an associated obligation to allow the lessee to use the asset. In other cases, ie when the significant risks or benefits of the leased asset are transferred to the lessee, the lessor would derecognise the portion of the asset that is transferred by the lease agreement.

48. During 2011 and 2012 the IASB and FASB have been considering the comments received on the exposure draft. In July 2011 the boards decided that, although they had not completed all of their deliberations, they had sufficient information to be able to conclude that they should re-expose the leases proposals.

49. Although the boards have addressed many of the issues raised by respondents to the exposure draft, we are aware of some remaining concerns about whether all leases should be accounted for in the same way. For example, some have questioned whether the profit and loss profile for lessees, which tends to be 'front loaded', is appropriate for all leases. While the redeliberations are substantially complete, the boards are reconsidering the appropriate profit and loss profile for lessees in light of feedback already received (ie before publishing the new exposure draft). The more fundamental issue of the

recognition of assets and liabilities on the balance sheet is not being reconsidered.

50. In January 2012 the leases working group was convened to discuss this issue. At the February 2012 meeting, the boards used the input received from the working group to further discuss lessee accounting and, in particular, different methods of amortising the so-called right-of-use asset recognised by lessees. The boards asked the staff to perform further outreach on those different methods to assess their operationality and usefulness for users of financial statements. The staff will report back to the boards in the second quarter of 2012.

51. The boards are targeting completing deliberations and issuing exposure drafts in the second half of 2012. During the comment period, the boards plan to conduct additional outreach with users of financial statements and entities that undertake lease activities. We expect a final standard in mid-2013.

Other projects

Insurance contracts

52. 'Insurance contracts' has been an active project for the IASB since the IASB was formed in 2001. It is an important project because IFRSs currently lack specific accounting requirements for insurance contracts. In 2007 the IASB published a discussion paper, *Preliminary Views on Insurance Contracts*. In October 2008 the FASB added a project on insurance contracts to its agenda and the boards agreed to undertake it jointly. The FASB and the IASB are at different points in the process on the insurance contracts project. The IASB issued an exposure draft, *Insurance Contracts*, in July 2010. The FASB published a discussion document of its own, which included alternative views, in September 2010.

53. In 2011, the boards began considering together the feedback received on the IASB's exposure draft and the FASB Discussion Paper. In general, the boards are developing a model that would reflect current estimates of the amount necessary to fulfil an insurance obligation. However, the boards have not reached consistent

conclusions about several elements of the model. There is a strong desire for a global standard on insurance, and the boards are undertaking an effort to gain a deeper understanding of the decisions taken by each Board to identify potential opportunities to resolve differences. The boards currently estimate that they will conclude the major technical discussions in the second quarter of 2012, with a FASB exposure draft in the second half of 2012. The IASB is considering whether it should publish another exposure draft or proceed to a final IFRS. Issuing an exposure draft would align the boards' consultative processes. On the basis of this plan, final standards could be issued in 2013.

Consolidation

54. The boards have completed their respective consolidation projects, which included addressing issues about the consolidation of special purpose entities and enhanced disclosures about off balance sheet risks. The new IFRS requirements will also bring into force new disclosure requirements relating to structured entities (special purpose entities), making IFRS and US GAAP disclosure requirements similar.

55. Differences remain, however, in relation to what US GAAP refers to as voting interest entities; US GAAP has a legalistic approach to defining control, whereas the new IFRS has a broader definition of control, including effective control. On the basis of feedback received, the FASB also decided to expose the principal-agent sections of the IFRS model.

Investment entities

56. The boards are also seeking to align the criteria for determining whether an entity is an investment company or investment entity whose substantive activity is investing for capital appreciation, investment income, or both.

57. The project objective is to define an investment entity and to require that an investment entity should not consolidate investments in operating entities that it

controls, but should measure those investments at fair value, with changes in fair value recognised in profit or loss.

58. The IASB published its proposals, which were developed with the FASB, in August 2011. The IASB's proposal provides an exception to the consolidation principle and equity method guidance for a particular class of entities—investment entities (which would result in measuring controlled investees and investments over which the entity can exercise significant influence at fair value through profit or loss).

59. The FASB exposure draft was issued in November 2011. The FASB's proposal would largely converge the criteria to determine whether an entity is an investment company with the IASB's proposal. Current US GAAP provides complete accounting and reporting guidance for investment companies. Under current US GAAP, an entity that meets the criteria to be an investment company would be required to measure all of its investments at fair value with all changes in fair value recognised in net income.

60. The boards plan to commence joint redeliberations of their proposals in the second quarter of 2012. On the basis of this timing, a final standard is targeted for the end of 2012.

Agenda consultation (IASB)

61. In addition to finalising the MoU projects, the IASB is working on topics for its future technical agenda. On 26 July 2011 the IASB launched its first formal public agenda consultation on its future work plan. Comments were requested by 30 November 2011. Through the agenda consultation, the IASB is seeking input from all interested parties on the strategic direction and the broad overall balance of the work plan. The agenda consultation will provide the IASB with important input when considering possible agenda items.

62. In January 2012 the IASB discussed the staff's summary of feedback received on the agenda consultation. The staff did not make any recommendations and the IASB was not asked to make any technical decisions. The IASB requested

that the staff should do further research to clarify some matters raised in the comment letters and suggested further ways in which the priorities for standards-level projects could be assessed. The IASB expects to discuss a development plan in the second quarter of 2012.