At the Group of 20 Summit in Pittsburgh, held in September 2009, the G20 leaders stated “We call on our international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011.”

Closely following the Pittsburgh Summit, in November 2009 a joint statement issued by the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) (collectively, the Boards”) reaffirmed their commitment to improving International Financial Reporting Standards (IFRSs) and U.S. generally accepted accounting principles (U.S. GAAP) and achieving their convergence. That statement affirmed June 2011 as the target date for completing the major projects listed in the 2006 Memorandum of Understanding (MoU), as updated in 2008. The statement also described project-specific milestone targets, and acknowledged the need to intensify standard-setting efforts to meet those targets.

In its meeting in June 2012 held in Los Cabos, Mexico the G20 agreed to the Boards’ new deadline of mid 2013 for the completion of and issuance of standards on key convergence projects, as the original deadline had been missed due to the responses received on the joint projects and debates between the Boards’ as to the direction of some of the joint projects.

The IASB updated its work plan on 20 December 2011 to reflect the amended timetable for its projects. This publication provides highlights of the current IASBs and FASBs work plan.

This guide provides an overview of the key features of projects by the Boards’ that are in progress or that have an effective date on or after 1 January 2012.

The guide incorporates activities and tentative decisions made up to 30 June 2012 and the Boards’ decisions are all subject to change.

Summary of Joint Projects

- Financial instruments
- Revenue recognition
- Leases
FINANCIAL INSTRUMENTS: CLASSIFICATION AND MEASUREMENT

Background
The financial instruments project addresses classification and measurement; impairment; hedging and offsetting. The Boards’ overall objective for the financial instruments project was to simplify, improve and converge the accounting for financial instruments. The Boards’ initially deliberated the topics within the financial instruments project separately, except for offsetting (which was deliberated jointly), and this resulted in separate proposals. The IASB issued a final standard IFRS 9 Financial Instruments (IFRS 9) on classification and measurement and separate proposals on impairment and hedging.

The FASB issued one comprehensive Exposure Draft (ED) in May 2010 Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities (Topic 825) incorporating all the topics in the financial instruments project.

Classification and measurement
In November 2009, the IASB issued IFRS 9 containing requirements for classifying and measuring financial assets. In October 2010, the IASB added the requirements for classifying and measuring financial liabilities to IFRS 9 to complete this phase of the project. Most of the requirements for financial liabilities were carried forward unchanged from IAS 39 Financial Instruments: Recognition and Measurement (IAS 39).

However, some changes were made to the fair value option for financial liabilities to address the issue of own credit risk. In December 2011, the mandatory effective date of IFRS 9 was changed to annual periods beginning on or after January 2015. Early application of IFRS 9 continues to be permitted. Furthermore, these amendments issued in December 2011 no longer require entities to restate comparative figures. Instead, entities will be required to provide additional disclosures on the basis of the entity’s date of transition.

IFRS 9 requires entities to classify financial assets on the basis of the objective of the entity’s business model for managing the financial assets and the characteristics of the contractual cash flows. While the FASB’s proposals would require fair value measurement for many financial assets and liabilities, IFRS 9 permits greater use of amortised cost.

The FASB plans to complete its re-deliberations on classification and measurement in 2012. It is expected the FASB will as a minimum expose the proposed amendments to the FASB Accounting Standards Codification (Codification).

The table overleaf summarises some of the proposals from the FASB and the IASB in relation to classification and measurement of financial instruments.
### FASB's proposed Update

**Scope**
- All financial assets and financial liabilities, as defined (except those for which a specific scope exception has been provided)
- Non-public entities with less than $1 billion in assets would apply certain requirements in this model relating to loans, loan commitments, and core deposit liabilities 4 years after the original effective date.

**Measurement Approaches**
- Fair value
- Amortized cost
- Re-measurement amount (only for core deposit liabilities).

**Classification and Measurement Categories**
- Fair value through net income (FV-NI)
- Fair value through other comprehensive income (FV-OCI)
- Amortized cost.

**FV-OCI Classification and Measurement Criteria**

Three qualifying criteria must be satisfied:

1. Debt instrument held or issued with all of the following characteristics:
   a. There is an amount transferred to the debtor (issuer) at inception that would be returned to the creditor (investor) at maturity or other settlement, which is the principal amount of the contract adjusted by any original issue discount or premium.
   b. Contractual terms of the debt instrument identify any additional contractual cash flows to be paid to the creditor (investor) either periodically or at the end of the instrument’s term.
   c. Debt instrument cannot contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its initial investment, other than through its own choice.

2. Entity's business strategy for the instrument is to collect or pay the related contractual cash flows rather than to sell the financial asset or to settle the financial liability with a third party.

3. It is not a hybrid instrument for which applying Subtopic 815-15 on embedded derivatives would otherwise have required the embedded derivative to be accounted for separately from the host contract.

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### IFRS 9 for Financial Assets

**Scope**
- Items within the scope of IAS 39 Financial Instruments: Recognition and Measurement (IAS 39) which includes all types of financial instruments except:
  - those interests in subsidiaries, associates and joint ventures that are accounted for under IAS 27 Consolidated and Separate Financial Statements (IAS 27), IAS 28 Investments in Associates (IAS 28) or IAS 31 Interests in Joint Ventures (IAS 31)
  - financial instruments issued by the entity that meet the definition of an equity instrument in IAS 32 Financial Instruments: Presentation (IAS 32).

Please see IAS 39 for a comprehensive scope

**Measurement Approaches**
- Fair value
- Amortized cost
- Separate accounting of embedded derivatives from a liability host if particular conditions are met.

**Classification and Measurement Categories**
- Fair value through net income (FV-NI)
- Fair value through other comprehensive income (FV-OCI) (limited option for some investments in equity instruments)
- Amortized cost.

**Irrevocable election at initial recognition for investments in equity instruments that are not held for trading.**
Under the three-bucket approach, all financial assets are categorised in bucket 1 irrespective of credit quality and subsequently moved to bucket 2 and 3 based on their underlying credit risk characteristics (as credit deteriorates).

An impairment allowance would be recorded based on the risk management objective – linking qualification for hedge accounting to whether a hedge is consistent with a company’s risk management activities and whether such a criterion is understandable and auditable.

The FASB tentatively decided to prospectively require financial assets to be reclassified when (and only when) the business model changes, which should be very infrequent. Changes in business model that require reclassifications must be (1) determined by an entity’s senior management as a result of external or internal changes, (2) significant to an entity’s operations, and (3) demonstrable to external parties. The FASB will discuss at a future meeting whether to account for reclassification of financial assets prospectively as of the first day of an entity’s next reporting period or as of the last date of an entity’s reporting period in which the business model changes.

The Boards’ plan to consider how to account for reclassifications in their next meeting.

The IASB tentatively decided to extend the existing reclassification requirements in IFRS 9 to the FV-OCI category.

Financial assets initially placed into bucket 1 irrespective of credit quality and subsequently moved to bucket 2 and 3 based on their underlying credit risk characteristics (as credit deteriorates). An impairment allowance would be recorded based on the lifetime expected losses for the portion of assets expected to move to buckets 2 or 3 over the next 12 months.

Financial assets evaluated on a group basis would be categorised in bucket 2, while financial assets evaluated on an individual basis would be in bucket 3.

Assets would move into buckets 2 and 3 when:

1. There has been a ‘more than insignificant’ deterioration in credit quality, and
2. Likelihood of default is such that it is at least reasonably possible that the contractual cash flows may not be recoverable.

The Boards’ agreed to avoid bright lines indicating when lifetime expected losses should be recorded when applying the three-bucket approach to debt securities and consumer and commercial loans.

The Boards’ in meeting in May 2012 discussed whether, and in what circumstances, financial assets should be reclassified.

The Boards’ initial joint proposals on impairment

- Under the three-bucket approach, all financial assets are initially placed into bucket 1 irrespective of credit quality and subsequently moved to bucket 2 and 3 based on their underlying credit risk characteristics (as credit deteriorates).
- An impairment allowance would be recorded based on the lifetime expected losses for the portion of assets expected to move to buckets 2 or 3 over the next 12 months.
- Financial assets evaluated on a group basis would be categorised in bucket 2, while financial assets evaluated on an individual basis would be in bucket 3.
- Assets would move into buckets 2 and 3 when:
  1. There has been a ‘more than insignificant’ deterioration in credit quality, and
  2. Likelihood of default is such that it is at least reasonably possible that the contractual cash flows may not be recoverable.

The Boards’ in their meeting in May 2012 discussed whether, and in what circumstances, financial assets should be reclassified.

Next steps

The Boards’ are continuing to develop the credit impairment approach, which includes its application to debt securities, purchased loans and trade and lease receivables. The Boards’ have not yet concluded on whether the proposed credit impairment approach would improve the credit quality of financial assets. The Boards’ plan to expose this approach in 2012.

FINANCIAL INSTRUMENTS: HEDGING - GENERAL

Background

In May 2010 the FASB issued an exposure draft on hedge accounting and this exposure draft was meant to preserve the fundamental accounting structure of the U.S. GAAP hedging model, including what constitutes an eligible hedge strategy. The proposed changes to U.S. GAAP (ASC 815) included the following:

- Replacing the notion of a ‘highly effective’ hedge relationship with one that is ‘reasonably effective’, therefore lowering the bar on what constitutes a qualifying hedge
- Eliminating the shortcut method for interest rate swaps and the critical terms matching concept for other derivatives, while acknowledging that qualitative assessments of what constitutes ‘reasonably effective’ are acceptable in most instances
- Replacing requirements that hedges be reassessed every quarter with requirements that hedges be reassessed qualitatively (or quantitatively if necessary) only if circumstances suggest that the hedging relationship may no longer be reasonably effective.

The IASB issued its exposure draft on hedge accounting in December 2010, the proposed model is principle-based, and will more closely align hedge accounting with risk management activities undertaken by companies when hedging their financial and non-financial risk exposures. The proposals also included enhanced presentation and new disclosure requirements. The IASB is analysing and re-deliberating the responses received on the exposure draft after which a review draft will be published and will be available to view for a period of 90 days until a final draft of the standard is published.

As discussed above, the IASB issued separate proposals on hedge accounting to the FASB. The FASB issued a discussion paper in February 2011 titled Invitation to comment – Selected Issues about Hedge Accounting to solicit input on the exposure draft issued by the IASB on hedge accounting. Below we have highlighted the key areas under each of the proposals as set out by the IASB and FASB to hedge accounting.

Key areas of FASB’s discussion paper

The FASB’s discussion paper issued in February 2011 was seeking feedback on a number of significant changes proposed by the IASB to determine whether the IASB’s proposals are a better starting point for any changes to the U.S. GAAP hedging model. The primary areas for which the FASB was seeking feedback from U.S. constituents focused on differences from U.S. GAAP and include:

- Risk management objective – linking qualification for hedge accounting to whether a hedge is consistent with a company’s risk management activities and whether such a criterion is understandable and auditable

The FASB tentatively decided to prospectively require financial assets to be reclassified when (and only when) the business model changes, which should be very infrequent. Changes in business model that require reclassifications must be (1) determined by an entity’s senior management as a result of external or internal changes, (2) significant to an entity’s operations, and (3) demonstrable to external parties. The FASB will discuss at a future meeting whether to account for reclassification of financial assets prospectively as of the first day of an entity’s next reporting period or as of the last date of an entity’s reporting period in which the business model changes.

The Boards’ in their meeting in May 2012 discussed whether, and in what circumstances, financial assets should be reclassified.

Next steps

The Boards’ in their meeting in May 2012 discussed whether, and in what circumstances, financial assets should be reclassified.

The Boards’ joint proposals on impairment

- Under the three-bucket approach, all financial assets are initially placed into bucket 1 irrespective of credit quality and subsequently moved to bucket 2 and 3 based on their underlying credit risk characteristics (as credit deteriorates).
- An impairment allowance would be recorded based on the lifetime expected losses for the portion of assets expected to move to buckets 2 or 3 over the next 12 months.
- Financial assets evaluated on a group basis would be categorised in bucket 2, while financial assets evaluated on an individual basis would be in bucket 3.
- Assets would move into buckets 2 and 3 when:
  1. There has been a ‘more than insignificant’ deterioration in credit quality, and
  2. Likelihood of default is such that it is at least reasonably possible that the contractual cash flows may not be recoverable.

The Boards’ agreed to avoid bright lines indicating when lifetime expected losses should be recorded when applying the three-bucket approach to debt securities and consumer and commercial loans.

The Boards’ in their meeting in May 2012 discussed the application of the proposed expected credit loss model to lease receivables.

For lease receivables recognised as a result of the joint leases project, the Boards’ tentatively decided that an entity could elect either to fully apply the proposed ‘three-bucket’ model or apply a simplified approach in which those lease receivables would have an impairment allowance measurement objective of lifetime expected credit losses at initial recognition and throughout the lease receivables’ life.

Next steps

The Boards’ in their meeting in May 2012 discussed whether, and in what circumstances, financial assets should be reclassified.

The IASB tentatively decided to extend the existing reclassification requirements in IFRS 9 to the FV-OCI category.

The FASB tentatively decided to prospectively require financial assets to be reclassified when (and only when) the business model changes, which should be very infrequent. Changes in business model that require reclassifications must be (1) determined by an entity’s senior management as a result of external or internal changes, (2) significant to an entity’s operations, and (3) demonstrable to external parties. The FASB will discuss at a future meeting whether to account for reclassification of financial assets prospectively as of the first day of an entity’s next reporting period or as of the last date of an entity’s reporting period in which the business model changes.

The Boards’ plan to consider how to account for reclassifications in their next meeting.

The Boards’ joint proposals on impairment

- Under the three-bucket approach, all financial assets are initially placed into bucket 1 irrespective of credit quality and subsequently moved to bucket 2 and 3 based on their underlying credit risk characteristics (as credit deteriorates).
- An impairment allowance would be recorded based on the lifetime expected losses for the portion of assets expected to move to buckets 2 or 3 over the next 12 months.
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  1. There has been a ‘more than insignificant’ deterioration in credit quality, and
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Key areas of IASB’s exposure draft
The IASB’s exposure draft on hedge accounting requires the effectiveness assessment to be more principles based and this to be performed only prospectively. For a hedge to be considered effective, the following criteria would need to be met:

- As a result of an economic relationship the hedging instrument and the hedged item are expected to move in opposite directions due to a change in the hedged risk
- The impact of changes in credit risk are not of such magnitude that they dominate the changes in fair value of the hedged item or the hedging instrument

A one to one relationship between the hedged item and the hedging instrument is not required. However, if the expected relationship is not perfect an entity will have to adjust the hedge ratio to reflect this. The hedge ratio used should be expected to result in an offset between the movements of the hedged item and the hedging instrument.

Next steps
The IASB expects to make a draft of the final standard available in 2012 and the final standard is expected towards the end of 2012. The IASB is also developing proposals on macro hedge accounting and intends to issue an ED in the second half of 2012.

The comment period on the FASB’s discussion paper referred to above closed on 25 April 2011. The FASB is to analyse these comments for its re-deliberations which are expected in the second half of 2012.
Background
The Boards’ wish to develop a single, common revenue recognition model that can be applied to a wide range of industries and transactions. IFRS is perceived as lacking necessary application guidance for revenue, while U.S. GAAP has been criticized for complexity and inconsistency in the revenue recognition area. The Boards’ exposed their joint revenue recognition proposal for a second time in November 2011 as a result of significant changes made to their original proposals. Revenue would be recognised when an entity satisfies its obligations to customers, which occurs when the good or service is transferred to the customer.

Proposed revenue recognition model
The proposed model is based on the following five steps:

1. **Identify the contract with a customer** – Contracts can be written, verbal or implied. Contracts could be combined, but would not be required to be segmented.

2. **Identify the separate performance obligations in the contract** – A good or service would be distinct (i.e., a separate performance obligation) if either: (i) the entity regularly sells the good or service separately; or (ii) the customer can benefit from the good or service on its own or together with other readily available resources.

3. **Determine the transaction price** – The transaction price would be the amount of consideration that an entity expects to be entitled to in exchange for transferring promised goods or services to a customer. The transaction price would exclude credit risk.

4. **Allocate the transaction price to the separate performance obligations** – Estimated transaction prices would be allocated based on the standalone selling prices. A residual technique could be used for performance obligations with highly variable prices (e.g., software licences).

5. **Recognise revenue when (or as) the entity satisfies a performance obligation** – An entity would satisfy a performance obligation by transferring control of a promised good or service to the customer, which could occur over time or at a point in time. The amount of revenue recognised may be constrained (i.e., limited because of variable consideration and rights of return).

An entity would recognise a liability and a corresponding expense if a performance obligation satisfied over time becomes onerous provided the performance obligation is satisfied over more than one year.

Next steps
The comment period for the ED closed in March 2012 for both the IASB and FASB proposals and currently the comments are being analysed and it is anticipated that the re-deliberations on the proposals will take place at the end of 2012. The Boards’ have not yet proposed an effective date, but have indicated that it would not be before January 2015.
The Board’s also tentatively decided that a lessee should distinguish between these two different types of lease on the basis of whether the lessee acquires and consumes more than an insignificant portion of the underlying asset over the lease term. That principle should be applied by using a practical expedient based on the nature of the underlying asset as follows:

a. Leases of property (land or a building – or part of a building – or both) should be accounted for using the straight-line approach, unless:
   i. the lease term is for the major part of the economic life of the underlying asset; or
   ii. the present value of fixed lease payments accounts for substantially all of the fair value of the underlying asset.

b. Leases of assets other than property should be accounted for using an approach similar to that proposed in the 2010 Leases exposure draft, unless:
   i. the lease term is an insignificant portion of the economic life of the underlying asset; or
   ii. the present value of the fixed lease payments is insignificant relative to the fair value of the underlying asset.

Lessee accounting decisions made in June 2012
The Boards’ discussed lessor accounting, and tentatively decided to change the previous decisions on the lessor accounting model regarding when the receivable and residual approach would apply.

The Boards’ tentatively decided that a lessor should distinguish between leases to which the receivable and residual approach applies and leases to which an approach similar to operating lease accounting applies. The distinction would be made by using the same criteria as noted above for lessee accounting. Consequently, a lessor would apply the receivable and residual approach to leases for which the lessee acquires and consumes more than an insignificant portion of the underlying asset over the lease term.

Next steps
The Boards’ are close to completing re-deliberations and intend to re-expose the proposals in a new ED during the second half of 2012.

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Should you have any questions in relation to this publication or would like further information on the current status of the joint projects please contact:

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