BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

October 2007

IASB Update *is published as a convenience for the Board's constituents. All conclusions reported are tentative and may be changed or modified at future Board meetings.*

Decisions become final only after completion of a formal ballot to issue a Standard or Interpretation or to publish an Exposure Draft.

The International Accounting Standards Board met in London on 16 – 19 October, when it discussed:

- Conceptual framework
- Fair value measurements
- Financial instruments
- Puttable financial instruments and obligations arising on liquidation
- Financial statement presentation
- IAS 37 redeliberations
- Leases
- Annual improvements process
- Post-employment benefits
- IAS 24 *Related Party Disclosures*
- Share-based payment
- XBRL

The IASB also met with the Financial Accounting Standards Board in a joint meeting on 22 and 23 October, where they discussed:

- Conceptual framework
- Financial statement presentation
- Revenue recognition
- Derecognising assets and liabilities

Conceptual framework

Interaction between new framework and existing *Framework*

The Board considered issues arising from the interaction between Chapters 1 and 2 of the new framework and the existing *Framework* until the entire new framework is completed. The Board tentatively decided:

(a) to withdraw the relevant paragraphs on the objective and qualitative characteristics of financial reporting in the existing *Framework* and replace them with Chapters 1 and 2 when they are finalised.

(b) not to change the rest of the existing *Framework* as a consequence of publishing the new chapters, except for essential changes. The Board will determine at a later meeting which changes are essential.

(c) that amendments as a consequence of the new framework should not result in changes to IFRSs. The Board also asked the staff to consider if additional guidance is necessary because the previously existing guidance in the *Framework* had been changed.

(d) to apply the new chapters when they are finalised.

(e) to specify a separate effective date for constituents to apply each chapter, of at least one year after it is finalised. This is because IAS 8 requires management to consider applying the *Framework* when there is no applicable IFRS available.

Objective of financial reporting

The Board also reconsidered the objective of financial reporting. At its previous meeting the Board considered a proposed objective of financial reporting:

> The objective of general purpose external financial reporting is to provide financial information about the reporting entity that is useful to current and potential investors and creditors and others in making decisions in their capacity as capital providers.

At this meeting the Board observed that the proposed objective did not explicitly acknowledge that users other than capital providers might use financial reports. The Board asked the staff to consider whether the objective should explicitly refer to other users and, if so, how.

Phase B: *Elements and Recognition*—definition of an asset

The Board continued its discussions of a working definition of an asset, and tentatively decided:

- to focus the definition of an asset on a present economic resource, rather than on future economic benefits.
- to remove the assessment of likelihood from the definition of an asset.
- to focus the definition on the present, rather than on past transactions or other events.
- to ask the staff to clarify the notion of *other access* that links the entity to the economic resource, preferably without using the word *control*.

The FASB reached similar decisions at its meeting on 17 October 2007.

The IASB and the FASB will continue to discuss wording of the definition at their joint meeting on 22 and 23 October 2007 (see below).

Fair value measurements

There were two sessions at the October IASB meeting at which fair value measurement was discussed. In the first session, the Board discussed the comment letters received on the discussion paper *Fair Value Measurements*. The Board tentatively confirmed the project's objective to develop principles and measurement guidance for fair value measurements in IFRSs. The Board confirmed its plan to complete a standard-by-standard review of fair value measurements currently required or permitted in IFRSs to assess whether each standard's measurement basis was intended to be an exit price. For situations in which the measurement basis was not intended to be an exit price, the Board plans to assess whether it should develop additional measurement guidance.

The Board had expected to publish an exposure draft in early 2008. Because of the extension of the comment letter deadline and the volume and nature of

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the comments received, the Board now expects to publish an exposure draft in the second half of 2009.

At the second session the Board held an education session with representatives from the valuation profession about fair value measurements for assets and liabilities. No decisions were made.

Financial instruments

Hedge accounting

Some Board members and staff held discussions with a number of banks that apply cash flow hedge accounting to portfolios of items with interest rate risk. The purpose of those discussions was to understand any application issues that arose and to help the Board determine whether clarifications to IAS 39 *Financial Instruments: Recognition and Measurement* were necessary.

At this meeting, the staff summarised the results of the discussions. They observed that all of the banks, after investing substantial time and resources, were able to apply cash flow hedge accounting to portfolios of items with interest rate risk. However, the discussions had identified some issues that could be clarified, although none of these had prevented the banks from applying cash flow hedge accounting in accordance with IAS 39.

The Board tentatively decided that, for each of the issues identified, the staff should consider possible changes to IAS 39.

Puttable financial instruments and obligations arising on liquidation

The Board published the exposure draft *Financial Instruments Puttable at Fair Value and Obligations arising on Liquidation* in June 2006. The comment period ended in October 2006. An analysis of the 87 comment letters received was presented to the Board in January, and since then the Board has deliberated the issues raised by respondents.

At this meeting, the Board confirmed that a staff draft of a proposed amendment would be used as the basis for public round-table discussions with interested parties.

The Board also confirmed the following details for the round-table discussions:

- They will take place in London on Monday 12 November.
- There will be one or two 2-hour sessions.
- The staff will select those to be invited to attend on the basis of those who commented on the exposure draft.
- Participants will be asked to focus on the following questions:
  - The proposed amendment is the product of a short-term project aimed at creating a limited exception to the classification requirements of IAS 32 *Financial Instruments: Presentation*. Within that context does the exception contained in the proposed amendment meet the project's objectives? If not, why and what would you propose?
  - Are the proposals operational? If not, why and what changes would you propose?
  - Are there any issues not addressed in the staff draft that should be addressed? If so, what are they and why should they be addressed?

Financial statement presentation

The Board confirmed that capital management disclosures should be limited to equity and financial liabilities that an entity manages as capital; those disclosures should not include items included in the operating category. It tentatively decided that net presentation of cash receipts and payments related to items currently classified as cash equivalents should be permitted in the statement of cash flows and that the application guidance in paragraph 24(a)–(c) of IAS 7 *Statement of Cash Flows* should be retained.

The Board also made the following tentative decisions:

- for the purposes of the initial discussion document on financial statement presentation, the classification of dividends payable on ordinary shares and related changes in the financial statements should be based on the current classification of dividends payable as a liability. Thus, dividend payments on ordinary shares would not be classified in the equity section in the statement of cash flows.
- foreign currency translation adjustments related to consolidated subsidiaries and proportionately consolidated joint ventures should be presented in a new separate section in the statement of comprehensive income, rather than in the operating category. Foreign currency translation adjustments related to equity method investments should be classified in the category in which the equity method investment is classified in the statement of financial position.

The Board tentatively decided that, in principle, the effects of basket transactions (single transactions that involve multiple assets, or a combination of assets and liabilities, that would be classified in more than one category under the working format) should be allocated to the multiple categories in which the related assets and liabilities are classified. It directed the staff to develop some allocation methods for discussion at a future meeting.

IAS 37 redeliberations

The Board discussed situations in which there was uncertainty about past events and considered the consequences for recognition and measurement of liabilities.

It considered the example of a vendor that sold one hamburger on the last day of its reporting period. If that hamburger turned out to have been contaminated, the vendor would be required to pay compensation to the customer. Past experience indicated that one in every million hamburgers was contaminated.

The Board first considered whether the vendor had an obligation. It considered three views:

A The event giving rise to an obligation was the sale of a *contaminated* hamburger. It was uncertain whether the vendor had sold a contaminated hamburger, so it was uncertain whether it had an obligation.

B The need to pay compensation was a performance obligation arising from the sales contract. This obligation arose at the inception of the contract. It was uncertain whether the vendor had fulfilled the obligation (by delivering a good hamburger). Hence it was uncertain whether the obligation continued to exist.

C The event giving rise to an obligation was the supply of a hamburger that *might have been contaminated*. Having

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supplied a hamburger, the entity had to accept all of the unavoidable consequences, including an obligation to pay compensation if the hamburger was contaminated. It was certain that the obligation existed. Only the outcome was uncertain.

The Board rejected View B on the grounds that the performance obligation was to supply a good hamburger. The Board noted that if View A applied, the vendor would recognise a liability only if the available evidence indicated that it had an obligation. If View C applied, the vendor would recognise a liability when each hamburger was sold—the probability that the hamburger was contaminated would be taken into account in the measurement of the liability.

The Board tentatively concluded that the supply of a hamburger was not sufficient to give rise to an obligation. There must also be evidence that the hamburger was contaminated. If the entity had sold many hamburgers on the last day of the reporting period, previous experience might provide such evidence. However, because only one hamburger had been sold, other evidence would be needed.

The Board also considered an example involving a hospital operation. During the operation the patient died. Hospital management estimated that there was a 70 per cent chance that the hospital had been negligent and would have to pay compensation. The Board tentatively concluded that in this example there was sufficient evidence to indicate that the hospital had an obligation. It should recognise a liability. The possibility that the hospital had not been negligent should be taken into account in the measurement of the liability because it would reduce the amount that the hospital would rationally pay to settle the obligation or transfer it to a third party.

In the light of these conclusions, the Board decided that its views were more closely aligned with View A than with View C.

The Board tentatively decided not to specify a probability threshold (such as 'more likely than not') for judging whether a liability exists. In the Board's view the assessment of whether an entity had a present obligation should be a matter for judgement, taken on the basis of all the available evidence.

Leases

The Board discussed lease arrangements that give rise to additional obligations of the lessee, including obligations:

- to incur costs to return the leased item
- to return the leased item in a specified condition
- to maintain the leased item.

The Board discussed whether these obligations meet the definition of a liability and, if so, whether the liability exists at the commencement of the lease term, or at some point during the lease term. The Board tentatively decided that obligations to incur costs to return the leased item were liabilities that existed at the commencement of the lease term. The Board also discussed how the debit arising on the recognition of the liability should be treated, how the liability should be measured, and whether the obligations give rise to assets of the lessor.

The Board also discussed variable lease payments, including:

- rentals that are linked to an index such as the consumer price index, or are linked to market rentals
- rentals with a variable element linked to the lessee's operating or financial performance from the leased item, such as turnover or profit-based rentals
- rentals that increase with the lessee's additional usage of the leased item, such as excess mileage costs in car leases.

The Board considered whether the variable rentals meet the definition of a liability at the commencement of the lease term and, if so, how the liability should be measured. The Board tentatively decided that for rentals linked to an index or market rentals the lessee had a liability for both the fixed and variable components.

The discussion was primarily for educational purposes only. Except as noted above, no decisions were made.

Annual improvements process

The Board considered two proposed amendments recommended by the IFRIC for inclusion in the second annual improvements project.

Determining whether an entity is acting as a principal or as an agent

The Board noted that paragraph 8 of IAS 18 *Revenue* specifies the accounting for amounts collected on behalf of a principal. However, IAS 18 does not provide guidance on determining whether an entity is acting as a principal or as an agent. The Board tentatively decided that high level guidance based on existing guidance issued in some jurisdictions should be included in the Appendix to IAS 18 and asked the staff to prepare an amendment to the appendix accordingly.

Disclosures required for non-current assets (or disposal groups) classified as held for sale or discontinued operations

The Board identified a need to clarify the disclosure requirements for non-current assets (or disposal groups) classified as held for sale or discontinued operations in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. The Board confirmed that:

- IFRS 5 specifies disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations;
- disclosures in other IFRSs do not apply to such assets (or disposal groups) unless that other IFRS specifically requires a disclosure in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations; and
- disclosures about such assets (or disposal groups) may be necessary to comply with the general requirements of IAS 1 *Presentation of Financial Statements*.

However, the Board expressed concern that an entity would have to exclude from the notes to its financial statements information that relates to the liabilities within a disposal group or a discontinued operation. Such segregation might be burdensome and not meaningful, in particular because the measurement requirements of IFRS 5 would not affect such liabilities. The Board will consider this issue at a future Board meeting.

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Post-employment benefits

Classification of benefit promises

The Board continued its discussion of the definitions of benefit promises. The Board tentatively decided that the distinction between benefit promises should be based on the nature of the benefit promise in the accumulation phase only, and that classification should not be affected by longevity risk. The Board noted that the effect of longevity risk would be included in the measurement of the employer's liability for such promises whatever the classification of the benefit promise.

Measurement of benefit promises in the payout and deferment phases

The Board tentatively decided that the liability for a benefit promise should be measured according to its classification, regardless of whether the employee is in the accumulation, deferment or payout phase.

IAS 24 *Related Party Disclosures*

At this meeting the Board began its redeliberation of the amendments to IAS 24 proposed in the exposure draft *State-controlled Entities and the Definition of a Related Party*, published in February 2007, in the light of the comments received.

The Board discussed the project's objective and scope, noting the limited scope of this project. The Board tentatively decided:

- not to extend the proposed exemption to cases other than state-controlled entities.
- not to reconsider fundamentally the definition of a related party.
- not to include a 'best endeavours clause' in IAS 24. Such a clause would state that disclosure is not required if an entity is unable to obtain the necessary information despite using its best endeavours.
- not to include a specific materiality guideline for related party disclosures.
- not to extend the exemption to subsidiaries (not state-controlled) whose parents prepare consolidated financial statements available for public use.

The Board then discussed the proposed exemption for state-controlled entities. According to draft paragraph 17A(b) proposed in the exposure draft, the exemption would not be available for transactions with another state-controlled entity that influenced, or was influenced by, the reporting entity. The Board tentatively decided to clarify this condition as follows. The exemption would not be available if either:

(a) the reporting entity influenced a transaction with that other state-controlled entity, or that entity influenced a transaction with the reporting entity; or

(b) the reporting entity influenced, ie participated in, the operating and financial policy decisions of that other entity, or that entity influenced the operating and financial policy decisions of the reporting entity.

In this context, influence is sufficient to preclude the use of the exemption. Significant influence, as defined in IAS 24, is not required.

If a transaction occurs on non-market terms (draft paragraph 17B(a)), the exemption would not be available. The remaining indicators proposed in the exposure draft (paragraphs 17(B)(b) and (c), 17C and 17D) would remain as indicators that influence might have occurred, rather than as definitive criteria that influence had occurred. The staff will consider the wording of those criteria.

When the reporting entity does not qualify for the exemption, it should disclose all transactions with the other state-controlled entity, regardless of whether those transactions are on market terms.

The exemption would be available for entities that are subject to joint control by the state, rather than being limited to cases of control or significant influence by the state.

The Board will discuss at a future meeting whether the exemption would be available if a transaction was influenced by the state, rather than by a party to the transaction.

Share-based payment

Group cash-settled share-based payment transactions

The Board discussed a proposal by the IFRIC to amend IFRS 2 *Share-based Payment* and IFRIC 11 *IFRS 2—Group and Treasury Share Transactions*.

The IFRIC had been asked for guidance on how the following arrangements that are share-based and cash-settled should be accounted for by a subsidiary that receives services from its employees:

- The employees of the subsidiary will receive cash payments that are linked to the price of the equity instruments of the subsidiary;
- The employees of the subsidiary will receive cash payments that are linked to the price of the equity instruments of the parent of the subsidiary.

For both arrangements, the parent (not the subsidiary) has an obligation to make the required cash payments to the employees of the subsidiary.

The Board agreed with the IFRIC's proposal to amend IFRS 2 and IFRIC 11 to specify that the subsidiary should:

- apply IFRS 2 to the above cash-settled and share-based payment arrangements in its financial statements; and
- measure the employee services in accordance with the requirements applicable to cash-settled share-based payment transactions.

The Board directed the staff to prepare an exposure draft of the proposed amendments.

XBRL (eXtensible Business Reporting Language)

The IASC Foundation XBRL team gave an update on global XBRL adoption and how XBRL connects with IASB projects.

The discussion was for education purposes only. No decisions were made.

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Joint Meeting – IASB and FASB

The IASB met with the Financial Accounting Standards Board in a joint meeting on 22 and 23 October.

Conceptual framework

Phase A: *Objective and Qualitative Characteristics of Financial Reporting*

The boards tentatively decided that the forthcoming exposure draft on phase A will have a comment period of 120 days.

Phase B: *Elements and Recognition*—definition of an asset

The boards resumed their discussion of a working definition of an asset and tentatively decided:

> An *asset* of an entity is a present economic resource to which, through an enforceable right or other means, the entity has access or can limit the access of others.

Amplifying text accompanying the asset definition will describe *economic resource*, *enforceable right*, and *other means*.

Financial statement presentation

The boards discussed the proposed content and style of the discussion paper outlining their preliminary views. Board members had questions on aspects of the draft outline, but generally agreed with the staff's proposal. The boards also agreed with the list of remaining issues that the staff plan to discuss with the boards in the coming months. On the basis of that timetable, the discussion paper would be published in the second quarter of 2008.

Revenue recognition

In 2002 the Board launched its project on revenue recognition jointly with the FASB. The objective of the project is to develop a single coherent asset and liability model for revenue recognition. In such a model, revenue is a function of changes in assets and liabilities and is not based on the notions of realisation and the completion of an earnings process.

Throughout 2002–2006 the boards explored a model in which the assets and liabilities would be measured at fair value (a fair value model) and a model in which the assets and liabilities would be measured by reference to the customer consideration (an allocated customer consideration model).

In October 2006 the boards decided that instead of trying to forge a single, compromise model at this stage in the project, they should aim to get a better and more complete understanding about what both models would look like and what each would entail. They also decided that an initial due process document should explain and illustrate the two models and that this would form a basis for seeking comments from interested parties.

Therefore, over the past year, the staff and two groups of board advocates (each drawn from both boards) have developed two revenue recognition models. At this meeting, the staff provided a summary of each of the models together with some examples. The summaries and the examples were included in the observer notes for the meeting, available on the Website.

The session was primarily educational and no technical decisions were taken. Board members commented on aspects of the models that they wanted to see explained more fully in subsequent meetings.

Derecognising assets and liabilities

The Memorandum of Understanding states that the boards expect to have published by 2008 a due process document based on the results of staff research on derecognition. The objective at this meeting was to educate the boards on how the research has been conducted, and to present the staff's core conclusions on principles for derecognising financial assets measured at fair value.

The boards

- directed the staff to report back on two alternative views of when financial assets expected to settle financial liabilities should be presented together in the financial statements ('linked presentation')
- advised the staff to incorporate in the research report on derecognition a chapter that identifies potential issues that will need to be considered when the scope of research is extended beyond financial instruments
- indicated that the proposed derecognition principle was appealing and that they intend to maintain momentum in discussions with the objective of moving towards a common set of derecognition principles.

Future Board meetings

The Board will meet in public session on the following dates. Meetings take place in London, UK, unless otherwise noted.

2007

12—16 November

10—14 December

2008

21—25 January

18—22 February

10—14 March

14—18 April

21—22 April (joint with FASB)

19—23 May

16—20 June

21—25 July

15—19 September

13—17 October

20—22 October (joint with FASB), Norwalk, Connecticut, USA

17—21 November

15—19 December

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