

*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 Statement, Interpretation or Exposure Draft.*

The International Accounting Standards Board met in London on 20 – 23 June, when it discussed:

- Financial instruments
- Insurance
- Accounting standards for small and medium-sized entities
- Fair value measurement
- Amendments to IAS 37
- Conceptual Framework
- Update on IFRIC activities
- ASB project on pensions accounting
- IAS 33 *Earnings per share* – treasury stock method
- Technical plan

## Financial instruments

At their joint meeting held in April 2006, the IASB and the Financial Accounting Standards Board (FASB) agreed on a goal of publishing a due process document on financial instruments (as envisaged in the Memorandum of Understanding between the IASB and FASB) by January 2008.

At this meeting, the Board discussed the Board's involvement in the proposed document, possible contents of the document and a draft timetable.

The Board tentatively decided that the document should contain the Board's preliminary views and any other results of the Board's deliberations on individual issues, to the extent that such views can be reached by the target date for publication.

The Board also instructed the staff to consider whether the scope of the document should be all contractual rights and obligations that require delivery or exchange of an item rather than basing the scope on a definition of financial instruments. The aim of such an approach is to reduce the number of

adjustments to the scope and to be able to explain them better.

The Board confirmed that all issues relating to the derecognition of financial instruments should be included in a separate due process document that (as described in the Memorandum of Understanding) would set out the results of the staff's research.

The Board also discussed responses to the staff questionnaire on the presentation of changes in fair value of financial instruments. The Board directed the staff to continue this research.

## Insurance

A representative of the International Association of Insurance Supervisors (IAIS) summarised the IAIS's observations on issues arising as a result of the IASB's insurance contracts project. Representatives of the Committee of European Insurance and Occupational Pensions Supervisors briefed the Board on the Solvency 2 project in the European Union, and explained the role of accounting information in that project. A representative of the International Actuarial Association (IAA) described the IAA's activities to support the development of approaches for financial reporting and solvency. The materials for this session are available at [www.iasb.org/meetings/june2006.asp](http://www.iasb.org/meetings/june2006.asp). No decisions were made.

### Next steps

The Insurance Working Group meets in London on 29 and 30 June. Observer notes for this meeting are available at [www.iasb.org/meetings/wg\\_obs\\_ins.asp](http://www.iasb.org/meetings/wg_obs_ins.asp).

## Accounting standards for small and medium-sized entities

The Board discussed a revised draft Exposure Draft (ED) *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*. The draft reflected changes since the version discussed at the Board meeting in May 2006.

In reviewing the draft, the Board also considered comments made by members of the IASB staff as a result of their section-by-section review of the previous version.

The Board reached a number of decisions, among which the following are the more significant.

**Definition of an SME.** An entity that is economically significant in its home country would not automatically be regarded as publicly accountable. Each jurisdiction should decide whether some non listed entities should not be permitted to use the IFRS for SMEs and if so which ones.

### Pervasive measurement principles.

The draft ED includes some pervasive principles for recognising assets, liabilities, income, and expenses, based on the IASB *Framework*, and also some specially developed pervasive measurement principles not in the *Framework*. The Board asked the staff to redraft the specially developed measurement principles in consultation with a small group of Board members.

### Maintaining the IFRS for SMEs.

Approximately every two years, the Board will publish an omnibus ED of proposed amendments to the *IFRS for SMEs* based on new and amended IFRSs and other proposals for change.

### Sections of the draft ED that require significant rewriting.

The draft *IFRS for SMEs* has 40 topical sections. The following are likely to require substantial rewriting: financial instruments, provisions, employee benefits, income taxes, and business combinations.

## SMEs (continued)

**Financial instruments.** The Board discussed proposals to simplify IAS 39 *Financial Instruments: Recognition and Measurement* for SMEs in three areas:

- classification of financial instruments (the ED would propose only two categories of assets and liabilities for SMEs).
- derecognition.
- limited relief from hedge accounting focused on the two types of hedging that an SME is likely to do.

The Board expressed general agreement with the thrust of the proposals and identified several matters for which revision or amplification is needed. The Board will make a decision on whether to adopt this approach at a future meeting.

**Cash flow statement.** Add guidance on cash and cash equivalents. Add guidance on when cash flows can be reported net. Disclose total taxes paid. Disclose the effect of exchange rate changes on cash and cash equivalents separately from operating, investing, and financing activities. Add guidance on reporting cash flows from acquisitions and disposals of subsidiaries.

### Accounting policies:

- When an entity has adopted an accounting policy for an event or circumstance for which the *IFRS for SMEs* allows an accounting policy choice, disclosure of the chosen policy is required.
- State that inappropriate accounting policies are not rectified by disclosure.
- Clarify that it is inappropriate to make, or leave uncorrected, immaterial departures from the *IFRS for SMEs* to achieve a particular presentation of an entity's financial position, performance or cash flows.
- Explain that a change in measurement basis is a change in accounting policy.

**Model financial statements.** Michelle Fisher of Deloitte Hong Kong was credited with having prepared the model financial statements included in the draft ED. The Board welcomed the model statements. The Board concluded that the illustrative balance sheet should show assets and liabilities in a 'current followed by non-current' sequence, rather than the other way round.

**Invitation to comment.** Ask a question about the adequacy of the guidance included in the standard and which specific areas need additional guidance.

**Business combinations.** Standards for applying the purchase method should be included in the *IFRS for SMEs* rather than addressed by cross-reference to IFRS 3 *Business Combinations*.

**Government grants.** The section on government grants should reflect the principles in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. Grants related to agricultural assets measured at fair value through profit and loss should be addressed in the section on Agriculture.

**Leases.** Discussion of lessor accounting for finance leases should be deleted and replaced by a cross-reference to IAS 17 *Leases*.

**Agriculture.** Circumstances in which an SME would use the cost model should be less restrictive than those currently in IAS

41 *Agriculture*. An SME should use the cost model if fair value is not readily determinable.

**Internally generated intangible assets other than goodwill.** The expense model (charge costs to expense when incurred) will be in the *IFRS for SMEs*. An SME wishing to follow the capitalisation model in IAS 38 *Intangible Assets* would be referred to IAS 38 for guidance.

**Impairment of assets.** The section on impairment should be titled Impairment of Non-financial Assets.

**Employee benefits.** Because many SMEs provide benefits under deferred benefit plans or government-mandated programmes that are similar, include guidance on defined benefit plan accounting in the *IFRS for SMEs* rather than by cross-reference to IAS 19 *Employee Benefits*.

**Interim financial reporting.** If an entity does not routinely prepare interim financial statements, but is required to do so on a one-time basis (perhaps in connection with a business combination), allow its prior annual financial statements to be used as comparative figures, if it is impracticable to prepare financial statements for the comparable prior interim period.

**Receivables from sale of an entity's own equity.** Clarify that these should be shown as an offset in the equity section of the balance sheet, not as an asset.

## Fair value measurement

The Fair Value Measurement (FVM) project is included in the Memorandum of Understanding with the FASB and seeks to issue converged guidance on measuring fair value by 2008. The objective of the project is to define fair value more clearly and to provide guidance on measuring fair value when its use is required by another standard. The project is not intended to require additional fair value measurement or to increase the use of fair value in IFRSs.

The FVM project was added to the Board's agenda in September 2005. At that time, the Board observed that the FASB was nearing completion of its comparable FVM project. Given the urgent need for consistent guidance on measuring fair value, the Board decided to publish the FASB's final FVM statement as an IASB exposure draft. Some constituents had expressed concern at this decision, suggesting instead that the Board should publish the FASB's final statement as a discussion paper. In response, and recognising the need for additional input from constituents before publishing an exposure draft, the Board decided to publish the FASB's final FVM statement as a discussion paper. The Board directed the staff to develop a revised project plan and timetable to reflect this decision. The Board also directed the staff to incorporate round-table discussions into the project plan in order to engage constituents in an open discussion of the FASB's statement and the implications of applying its provisions to IFRSs.

The Board also discussed guidance in IAS 39 *Financial Instruments: Recognition and Measurement* and in the draft FVM statement on initial measurement of financial instruments at fair value. The Board had previously expressed a preference for the exit price notion of fair value as defined in the FASB's draft FVM statement. Furthermore, the Board had previously tentatively concluded that a transaction price paid to acquire an asset or received to assume a liability is conceptually different from the exit price notion of fair value. In contrast, paragraph AG64 of IAS 39 states that 'the fair value of a financial

instrument on initial recognition is normally the transaction price (ie the fair value of the consideration given or received). The Board directed the staff to include a question in the invitation to comment discussing the divergent guidance in the FASB's FVM statement and IAS 39 on measuring fair value at initial recognition.

## Amendments to IAS 37

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The Board resumed its consideration of issues associated with the recognition principle proposed in the IAS 37 Exposure Draft (ED).

### Omitting the probability recognition criterion

The recognition principle in the ED would require an entity to recognise a liability when (a) the definition of a liability has been satisfied and (b) the liability can be measured reliably. This is different from IAS 37 in that IAS 37 also specifies that a liability (provision) should be recognised only if it is probable (more likely than not) that an outflow of resources will be required to settle the obligation.

The Board noted that many respondents to the ED disagreed with the proposal to omit this probability recognition criterion from IAS 37. In particular, respondents noted that the criterion is derived from the *Framework* and hence viewed its omission as being inconsistent with the *Framework*.

In reconsidering this proposal, the Board noted the following points.

- The *Framework* does not explain what recognition threshold is meant by 'probable': the 'more likely than not' threshold exists only in standards-level guidance. Furthermore, a 'more likely than not' threshold in the *Framework* would result in the flawed conclusion that a performance obligation arising from a guarantee, a warranty or an insurance contract should not be recognised until it is probable that a claim will arise.
- The probability recognition criterion as articulated in the *Framework* and IAS 37 is not related to determining whether a liability exists. The Board acknowledged that probability may have a role when it is uncertain whether a liability exists (ie in resolving element uncertainty). However, that role would be similar to paragraph 15 of IAS 37 (ie is it probable that a liability exists?) rather than paragraph 14(b).
- Liabilities are identified using the liability definition. Once a liability has been identified, the probability recognition criterion in IAS 37 would in almost all cases not be a determinant for recognition, because *some* outflow of resources would be probable.
- A probability recognition criterion is inconsistent with the measurement requirements proposed in the ED (and, indeed, is largely inconsistent with the measurement requirements of IAS 37). This is because the ED proposed that the measurement of a liability should incorporate all possible outcomes, regardless of whether they are more likely than not. If a liability exists and it can be measured reliably, the effect of the probability recognition criterion is to delay the inclusion of decision-useful information in the balance sheet. The Board acknowledged that measurement uncertainty may preclude recognition and, in due course, it will consider whether additional guidance about measurement uncertainty is required.

The Board noted that its final conclusions about the probability recognition criterion would depend on affirming the measurement proposals and its continuing work on element uncertainty. However, the Board directed the staff to proceed on the basis that the revised IAS 37 should not include a probability recognition criterion.

### Determining whether an entity has a liability when the existence of a present obligation is uncertain

The Board continued the previous meeting's discussion of element uncertainty in the context of litigation. In particular, the Board reconsidered the conclusions in Example 1 (disputed lawsuit) and Example 2 (potential lawsuit) in the illustrative examples accompanying the ED.

The Board noted respondents' arguments that the ED provides insufficient guidance on how to address element uncertainty in the context of litigation and that the conclusions in Examples 1 and 2 are contradictory.

After reconsidering the conclusions in Examples 1 and 2, the Board concluded that:

- Examples 1 and 2 in the ED are contradictory.
- the conclusion in Example 2 is correct. The likelihood that an external party will detect an entity's violation of the law or breach of contract is not relevant in determining whether the definition of a liability is satisfied (but it would affect the measurement of the liability).
- the conclusion in Example 1 is incorrect. The start of legal proceedings, in itself, does not obligate an entity. Rather, the start of legal proceedings is another piece of evidence that may be relevant when an entity evaluates whether a liability exists.

The Board also decided that the illustrative examples accompanying any final Standard should include additional guidance on how to address element uncertainty in the context of litigation (and similar regulatory actions).

## Conceptual Framework

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The Board continued its discussion of matters related to Phase B: Elements and Recognition of the joint IASB/FASB Conceptual Framework project by analysing the application of the working definition of an asset to certain situations—a forward contract between a farmer and a canner for corn, and an entity's own shares. These situations were analysed to address the following concerns raised by FASB and IASB members at their joint meeting in April 2006:

- The need for a better understanding of what constitutes an economic resource.
- The question of whether the asset is the economic resource or the right.
- The contention that the proposed definition of an asset would result in an entity's own shares being considered an asset.

The proposed working definition of an asset considered in April was as follows:

An *asset* is a present economic resource of an entity. An asset of an entity has three essential characteristics:

- There is an underlying economic resource.
- The entity has rights or other privileged access to the economic resource.
- The economic resource and the rights or other privileged access both exist at the financial statement date.

Applying this working definition to a forward contract to buy/sell corn between a canner and a farmer, the Board concluded that:

- the economic resources are the promises in the contract; the canner's economic resource is the farmer's promise to deliver corn at the agreed price, and the farmer's economic resource is the canner's promise to take delivery of the corn and to pay the agreed price. In this situation, the economic resource is not the corn.
- the canner and the farmer are connected to their economic resource—the promises they received—by means of contractual rights that provide each with the means to control and benefit from their economic resource.
- the economic resources and the rights to the economic resources both exist during the period the contract is outstanding.

Thus, the canner and the farmer both have assets. Subsequent parts of the conceptual framework project will assess whether assets are recognised, and how they are measured and presented.

In considering an entity's own shares (unissued shares and treasury shares), the Board concluded that they are not assets as the essential characteristics are not met. There are no promises with external parties—no one will require actions (or inactions) to be taken.

The FASB separately discussed the same issues and reached similar conclusions. In July, the FASB and the IASB will consider the revised working definitions of assets and liabilities and amplifying text, together with further examples illustrating their application.

## Update on IFRIC activities

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The staff asked the Board to approve for issue an Interpretation developed by the IFRIC after considering comments received on D18 *Interim Financial Reporting and Impairments*.

The Board noted that the proposed text stated in the Basis for Conclusions that the Interpretation should not be applied by analogy to other conflicts with IAS 34 *Interim Financial Reporting*. The Board considered that, as a matter of policy, such paragraphs should be included within the Consensus rather than in the Basis for Conclusions. It asked the staff to revise the draft to reflect this policy.

Subject to this amendment, and some minor drafting points, the Board approved the Interpretation for issue.

The Board discussed whether so-called economic compulsion should affect the classification of a financial instrument (or a component of a financial instrument) under IAS 32 *Financial Instruments: Presentation*. This issue had previously been debated at the IFRIC meetings in March and May 2006.

For a financial instrument (or a component of a financial instrument) to be classified as a financial liability under IAS 32, the issuer must have a contractual obligation either:

- to deliver cash or another financial asset to the holder of the instrument, or
- to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer.

(Different requirements apply to financial instruments that may or will be settled in the issuer's own equity instruments.) The Board confirmed that such a contractual obligation could be established explicitly or indirectly, but it must be established through the terms and conditions of the instrument. Thus, by itself, economic compulsion would not result in a financial instrument being classified as a liability under IAS 32.

The Board also stressed that IAS 32 requires an assessment of the substance of the contractual arrangement. It does not, however, require or permit factors not within the contractual arrangement to be taken into consideration in classifying a financial instrument.

## ASB project on pensions accounting

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The Board held a session to discuss the project on pensions accounting being led by the UK Accounting Standards Board. The meeting was for education only and no decisions were made. The observer note is available at: [www.iasb.org/meetings/june2006.asp](http://www.iasb.org/meetings/june2006.asp)

## IAS 33 *Earnings per share* – treasury stock method

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The Board decided not to proceed with the amendment to IAS 33 that was proposed at the January 2006 meeting to include the carrying amount of instruments (or components of instruments) classified as equity in assumed proceeds when using the treasury stock method. The Board confirmed its intention to proceed with the proposed amendments to include the carrying amount of instruments classified as liabilities in assumed proceeds when using the treasury stock method and to extend this method to convertible instruments.

## Technical plan

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The Board made its quarterly review of its Technical Plan. The Technical plan sets out the expected timetable over the coming 18-24 months for projects on the IASB's active agenda.

The Board publishes the timetable on its website following each quarterly review of the Technical Plan. Updated projects summaries are available on the IASB Website at <http://www.iasb.org/current/iasbworkplan.asp>.

### **Meeting dates: 2006 and 2007**

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

17—21 July

18—22 September

16—20 October

23—24 October (joint with FASB), Norwalk, Connecticut, USA

13—17 November

11—15 December

22—26 January

19—23 February

19—23 March

16—20 April

23—24 April (joint with FASB), London

14—18 May

18—22 June

16—20 July

17—21 September

15—19 October

22—24 October (joint with FASB), Norwalk, Connecticut, USA

12—16 November

10—14 December