BOARD DECISIONS ON INTERNATIONAL ACCOUNTING STANDARDS

IASB UPDATE

December 2002

The International Accounting Standards Board met in London on 18-20 December 2002, when it discussed:

- Amendments to IAS 32 and IAS 39
- Business combinations (phase II)
- Convergence of accounting standards
- Employee benefits
- Financial activities
- First-time application of IFRSs
- IFRIC matters
- Improvements to existing standards
- Income statement (reporting performance)
- Revenue recognition

## Amendments to IAS 32 and IAS 39

**Public roundtable discussions**

The Board decided that it will hold a series of public roundtable discussions with respondents to the recent exposure draft of proposed amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement.* The Board will invite all individuals and organisations that submitted comment letters on the exposure draft up to 18 December 2002, as well as other interested parties and experts in this area who can assist it in reaching final conclusions. In addition, other constituents who would like to attend can express an interest and send the Board a comment letter by 17 January 2003, in which case, they will be admitted where possible. The roundtable discussions will be open to observation by the public and will provide an opportunity for those who have commented on the exposure draft to expand upon, explain further, and discuss their views on the proposals with the Board. The roundtables will be held during the week of 10 March 2003. Details of these meetings, including venues, will be available on the IASB's Website (www.iasb.org.uk) once scheduled.

**Proposed amendments**

The Board considered the approach to finalising proposed amendments to IAS 32 and IAS 39 that were exposed for public comment in June 2002 and for which the comment period expired in October 2002.

The Board agreed that consolidating IAS 32 and IAS 39 into a single, comprehensive Standard should not be a priority at this time. Improving the standards should be the first priority.

The Board agreed that a small group of Board members would review existing implementation guidance on IAS 39 once the amendments have been agreed to recommend the extent to which the guidance needs to be revised or eliminated as a consequence of the amendments to IAS 39.

In light of the responses from constituents to the exposure draft, the following were identified as issues that merit the Board's particular attention in finalising the amendments to IAS 32 and IAS 39:

*Issues related to the classification of financial instruments as financial liabilities or equity instruments:*

- financial instruments for which the manner of settlement in financial assets or own equity depend on uncertain future events or circumstances that are beyond the control of both the issuer and the holder of the instrument
- existence of economic compulsion for an entity to redeem a financial instrument in cash or other financial assets
- the separation of liability and equity elements of a compound financial instrument
- derivatives on own equity instruments
- a parent's guarantee of the distributions of a subsidiary
- derivatives on interests in subsidiaries, associates and joint ventures.

*Issues related to the derecognition of financial assets*

- principles underlying derecognition
- pass-through arrangements.

*Issues related to the measurement of financial instruments*

- measurement of financial guarantees subsequent to initial recognition
- the option to measure financial instruments at fair value
- impairment in groups of originated loans
- reversal in profit or loss of impairment of available-for-sale financial assets.

*Issues related to hedge accounting*

- hedge accounting principles
- macro hedges
- internal contracts
- hedges of firm commitments
- basis adjustments when a cash flow hedge results in an asset or liability.

## Business combinations (phase II)

**Issues related to controlling and minority (non-controlling) interests**

The Board continued its discussion of issues involving the accounting and reporting of controlling and minority interests in consolidated financial statements. The Board considered the following issues:

- Accounting for step acquisitions.

*(continued...)*

**Copyright © IASB Update is published immediately after every IASB meeting by the International Accounting Standards Board,**
**30 Cannon Street,**
**London EC4M 6XH, United Kingdom**
**E-mail: iasb@iasb.org.uk**
**Internet: www.iasb.org.uk**

**IASB Publications Department,**
**30 Cannon Street, London, EC4M 6XH**
**United Kingdom**
**Tel: +44 (0)20 7332 2730**
**Fax: +44 (0)20 7332 2749**
**E-mail: publications@iasb.org.uk**
**ISSN 1474-2675**

- Accounting for subsequent increases and decreases in ownership of a subsidiary by members of the consolidated group while the parent controls the subsidiary.
- Accounting for subsequent decreases in ownership of a subsidiary by members of the consolidated group that result in a loss of control.
- Display of minority interests in the consolidated income statement.
- Display of minority interests in the consolidated statement of changes in equity.
- The level of detail, if any, that should be disclosed for the amounts attributable to the controlling and minority interests for individual line items in the consolidated income statement and statement of changes in equity.
- Attributing losses between controlling and minority interests.

*Accounting for step acquisitions*

A business combination may involve more than one exchange transaction, for example, when it occurs in stages by successive share purchases (a business combination referred to as a step acquisition). The Board agreed that if an acquirer obtains control of an acquiree in a step acquisition, the carrying amount of the previous investment in the acquiree held by the acquirer should be increased to its fair value on the acquisition date and any gains or losses on remeasurement to fair value should be recognised in consolidated profit or loss for the period. If the previous investment in the acquiree held by the acquirer is classified as an available-for-sale financial asset, the cumulative gain or loss arising from a change in the fair value of that investment previously recognised in equity should be recognised in consolidated profit or loss for the period on the acquisition date.

*Accounting for subsequent increases and decreases in ownership of a subsidiary by members of the consolidated group while the parent controls the subsidiary*

The Board agreed that after a parent acquires control of a subsidiary, subsequent increases or decreases in the ownership interests of the subsidiary by members of the consolidated group while the parent controls the subsidiary should be accounted for as equity transactions in the consolidated financial statements. Therefore, premiums or discounts, if any, for amounts paid (or received) for subsequent investments purchased from (or sold to) minority shareholders in excess (or deficit) of the carrying basis of the ownership interest purchased (or sold) should be recognized directly in equity.

*Accounting for subsequent decreases in ownership of a subsidiary by members of the consolidated group that result in a loss of control*

The Board agreed that if a parent disposes a subsidiary through a sale of ownership interests in that subsidiary by the parent or members of the consolidated group (a decrease in ownership that results in a loss of control by a parent), any gain or loss on the sale should be recognized in consolidated profit or loss for the period. The gain or loss should be calculated as the difference between (a) the proceeds from the sale that resulted in the loss of control and (b) the carrying amount of the subsidiary's net assets in the consolidated financial statements, less the carrying amount of any minority interests in the consolidated financial statements, and less the fair value of any investment remaining in the entity sold.

*Display of minority interests in the consolidated income statement*

The Board agreed that amounts for both net profit or loss attributable to minority interests and net profit or loss attributable to the controlling interest should be presented on the face of the consolidated income statement in addition to presenting consolidated net profit or loss. Further, the Board agreed not to prescribe a specific presentation format in the consolidated income statement.

The Board considered whether the effects of capital transactions for purchases (and sales) of subsidiary shares from (to) minority shareholders that generally are shown in a statement of changes in equity should be displayed on the face of the consolidated income statement and rejected such a presentation.

*Display of minority interests in the consolidated statement of changes in equity*

The Board agreed that amounts for both an entity's total income and expenses (including those that are recognised directly in equity) attributable to the controlling interest and an entity's total income and expenses (including those that are recognised directly in equity) attributable to the minority interests should be reported in the statement of changes in equity.

*The level of detail, if any, that should be disclosed for the amounts attributable to the controlling and minority interests for individual line items in the consolidated income statement and statement of changes in equity*

The Board agreed that individual line items in the consolidated income statement and statement of changes in equity should be presented on a consolidated basis on the face of the financial statements. The amounts attributable to the controlling and minority interests for individual line items would not be required to be presented on the face of the consolidated financial statements.

*Attributing losses between controlling and minority interests.*

The Board agreed that losses of a subsidiary should be attributed to both the controlling interest and minority interests on the basis of their ownership interests and contractual rights and obligations, if any, even if the losses exceed the minority interests' investment. The Board directed the staff to explore further whether the existence of a guarantee or other type of agreement should change the way losses are attributed between the controlling interest and minority interests.

**Recognition and measurement of deferred tax assets and valuation allowances**

The Board considered whether the current requirements for the subsequent recognition of deferred tax benefits acquired in a business combination that

- did not satisfy the criteria for separate recognition when initially accounting for a business combination, but
- are subsequently realised,

should be amended. Specifically, the Board considered whether the goodwill should continue to be reduced for the subsequent recognition of deferred tax benefits acquired in a business combination as currently required by IAS 12 *Income Taxes*. The Board agreed that goodwill should not be adjusted for the subsequent recognition of deferred tax benefits and that the acquirer should recognise those benefits as income as required by IAS 12. The Board also agreed that consequential


Copyright © 2002 International Accounting Standards Committee Foundation

amendments to IAS 36 *Impairment of Assets* are necessary to ensure that an impairment loss is recognised for goodwill to the extent that the loss arises because a deferred tax asset acquired in a business combination not recognised separately from goodwill at the acquisition date is subsequently realised.

**FASB project scope reconsideration**

The Board noted the FASB's decision to address certain issues previously excluded from the scope of its phase II of the business combinations project with the objective of determining whether convergence with the IASB is possible. These issues include matters relating to recognition of:

(a) Amendments to employee benefit plans that (1) are a condition of the business combination or (2) are intended changes by the acquirer to employee benefit plans of the acquiree

(b) Constructive obligations

(c) In-process research and development of the acquiree at the date of acquisition.

**Measurement of assets acquired and liabilities assumed in a business combination**

In the context of this project the FASB and the IASB, in accepting the working principle, agreed to use fair value as the measurement objective for valuing the assets acquired and liabilities assumed in a business combination. The Boards decided that their exposure drafts resulting from this joint project should provide guidance for measuring fair value in the form of a hierarchy.

At this meeting the Board considered whether the fair value hierarchy tentatively agreed at its June 2002 meeting should be refined. The Board agreed to clarify and modify the hierarchical guidance for measuring the fair value of assets acquired and liabilities assumed in a business combination. The Board agreed that the following fair value hierarchy should be accepted as a working version:

> *Level 1*—The estimate of fair value shall be determined by reference to observable prices of market[1] transactions for identical assets or liabilities at or near[2] the measurement date whenever that information is available.
>
> *Level 2*—If observable prices of market transactions for identical assets or liabilities at or near the measurement date are not available, the estimate of fair value shall be determined by adjusting observable prices of market transactions for similar assets or liabilities that occur at or near the measurement date. A similar asset or liability is one that is reasonably comparable, for example, one having similar patterns of cash flows that can be expected to respond similarly to those of the item being measured to changes in economic conditions. Generally, when an asset or liability is sufficiently similar to an asset or liability being measured, adjustments for any differences are objectively determinable[3].
>
> *Level 3*—If observable prices of market transactions for identical or similar assets or liabilities at or near the measurement date are not available, the estimate of fair value shall be determined using other valuation techniques. Valuation techniques shall be consistent with the objective of estimating fair value and incorporate assumptions that marketplace participants would use whenever market-based information is available without undue cost and effort. If market-based information is not available without undue cost and effort, an entity may use as inputs its own assumptions as a practical expedient; however, for any valuation technique, market inputs shall be maximized and use of internal estimates and assumptions shall be minimized. For example, if an entity is aware of unique advantages or disadvantages that it possesses, such as favourable labour rates, or superior processing or manufacturing technologies, it shall adjust its entity-specific assumptions such that the inputs into the valuation process or model reflect those that marketplace participants would incorporate in an estimate of fair value.

At the same time, the Board acknowledged that this level of fair value measurement guidance does not address certain important questions regarding fair value measurement and agreed that additional guidance should be developed to address those questions through a separate joint effort with the FASB.

**Scope – Identifiable assets and liabilities that did not satisfy the criteria for recognition separately from goodwill**

The Board considered whether the treatment of the acquiree's identifiable assets and liabilities that:

- did *not* satisfy the criteria for recognition separately from goodwill at the time of initially accounting for a business combination; but
- subsequently satisfy those criteria because of events that take place after the acquisition date

should be reconsidered in this project.

The Board agreed to reconsider whether to require that a non-identifiable non-monetary asset without physical substance that forms, at the acquisition date, part of the goodwill should be subsequently excluded from the carrying amount of goodwill and recognised separately if it becomes identifiable as a result of an event *after* the acquisition date in the following limited circumstances:

- a non-identifiable non-monetary asset acquired becomes identifiable within twelve months of the acquisition date, and
- the fair value of a non-identifiable non-monetary assets is reliably measurable at the acquisition date.

## Convergence

**Post-employment benefits**

The Board discussed the following issues:

- the expected return on plan assets
- definitions of defined contribution plans, defined benefit plans and plan assets.

*The expected return on plan assets*

The Board discussed the presentation of changes in value of plan assets, in particular whether a component representing income should be presented separately from other changes in value. Under IAS 19 *Employee Benefits* as currently drafted, estimated income (the expected return for the period) is presented separately from other changes in value, which are treated as actuarial gains and losses.

During the discussion the Board confirmed that in its income statement (reporting performance) project it wished to present changes in value of the defined benefit obligation as follows:

[1] "Market" refers to the markets to which the entity has reasonable access.

[2] Prices of market transactions near the measurement date (rather than at the measurement date) could be used to the extent that there were no changes in market conditions between the measurement date and the observable transaction date.

[3] For example, similar assets could be identical in all respects except for location. If the only difference between two assets were the location, the fair value would equal the observable price of an identical item in a different location plus costs to ship the item to the identical location as the asset being measured.

Copyright © 2002 International Accounting Standards Committee Foundation 

(a) service cost, within business activities in the income before remeasurement column

(b) actuarial gains and losses arising from changes in assumptions about the benefit cash flows, within business activities in the remeasurement column

(c) interest cost on the benefit obligation, in the financing section in the income before remeasurement column

(d) actuarial gains and losses on the benefit obligation arising from changes in interest rates, in the financing section in the remeasurement column.

The Board agreed that it wished to present changes in the value of plan assets in the business activities section relating to financial assets. Hence, the changes in the value of plan assets would not be offset against the changes in value of the defined benefit liability shown in the financing section.

Finally, the Board agreed that all changes in the value of plan assets would be presented in the remeasurement column. No expected or actual income on plan assets would be presented in the income before remeasurement column of the proposed income statement.

*Definitions*

The Board considered the definitions of defined contribution plans and defined benefit plans. It agreed to amend the definition of defined contribution plans to:

(a) address a potential for misinterpretation in the existing definition in IAS 19 relating to the status of over funded defined benefit plans and

(b) to classify plans with upside risk for employers as defined benefit plans.

The Board also considered the definition of plan assets. It agreed not to amend the existing definition.

**Joint ventures**

The Board discussed whether to consider removing the option of proportionate consolidation for joint ventures under IAS 31 *Financial Reporting of Interests in Joint Ventures* in the light of the discussion at the Board's meeting with national standard setters in October 2002 on the use of proportionate consolidation and equity accounting for joint ventures and associates. The view expressed at the national standard setters meeting was that many of the issues involved might be best addressed and resolved within the consolidation project.

Some Board members expressed concern that (i) IAS 31 would continue to offer a choice and (ii) proportionate consolidation was not conceptually justifiable. Therefore, it was agreed that the Australian Accounting Standards Board would be asked to scope a limited project covering:

- the definition of joint ventures and
- the distinction between a joint venture and an undivided interest in an asset

with a view to facilitating the removal of the proportionate consolidation option.

**Provisions for restructuring costs**

The Board considered issues relating to the possible convergence of (i) the recognition of provisions for restructuring costs under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (ii) the recognition of termination benefits under IAS 19 *Employee Benefits* with FAS 146 *Accounting for Costs Associated with Exit or Disposal Activities*.

The Board agreed to:

(a) make a limited amendment to the definition of a constructive obligation in IAS 37 to clarify that the actions of an entity must result in other parties being able to 'reasonably rely' on the entity discharging its responsibilities.

(b) withdraw the existing guidance on provisions for restructuring costs in IAS 37 (paragraphs 70-83) and to replace it with guidance that specifies the existence and announcement of a restructuring plan does not by itself create an obligation. The Board agreed that the revised guidance should specify the treatment of costs that are often incurred in a restructuring as follows:

   (i) the cost of employee termination benefits should be recognised in accordance with IAS 19 (see (c), below)

   (ii) the cost of terminating a contract before the end of its term should be recognised when the entity terminates the contract

   (iii) the liability for costs that will continue to be incurred under a contract for its remaining term without economic benefit to the entity should be recognised in accordance with the requirements for onerous contracts.

(c) amend the requirements for termination benefits in IAS 19 to specify that:

   (i) the recognition of involuntary termination benefits requires the communication of those benefits to the employees

   (ii) where employees are required to render service to be entitled to involuntary termination benefits, those benefits are recognised over the future service period

   (iii) voluntary termination benefits are recognised when employees accept the offer of voluntary termination.

The Board confirmed that it would not amend the measurement requirements of IAS 37 pending its measurement project and that it would not amend the requirements for onerous contracts pending its project on the definition of liabilities.

The Board also instructed the staff to develop additional explanatory material to accompany the revised definition of a constructive obligation and to explore the impact of its decision on the examples in IAS 37 Appendix C as well as on IAS 36 *Impairment of Assets*.

## Financial Activities

The Board discussed disclosure principles and requirements proposed by the Board's Financial Activities Advisory Committee. In addition to the advisory committee's recommended disclosure principles and requirements, the Board reviewed a summary of the relevant comments that have been received on the Exposure Draft of Proposed Amendments to IAS 32, *Financial Instruments: Disclosure and Presentation*, principally those relating to the financial risk disclosure requirements.

The advisory committee's recommendations included:

- a financial risk disclosure principle and requirements that all entities can apply
- three balance sheet and income statement disclosure requirements
- a plan for moving the project forward.

The Board expressed overall support for the advisory committee's recommendations subject to some minor amendments.

 Copyright © 2002 International Accounting Standards Committee Foundation

*Financial risk disclosure principle and requirements*

The draft financial risk disclosure principle states:

> *"An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of the entity's exposure to financial risks during the reporting period."*

The financial risk disclosure requirements that enable users to evaluate the entity's exposure to financial risks, consist of: (a) qualitative information about financial risk exposures and risk management policies and (b) quantitative data –"through the eyes of management". Minimum, qualitative and quantitative information would be required about:

- credit risk
- quality of assets – past due and impaired financial assets
- liquidity risk
- market risk.

The Board tentatively agreed that the disclosure of capital requirements imposed by external parties (for example, a regulator) should be required and asked the advisory committee to continue to develop a capital requirements disclosure principle.

*Operational risk disclosure*

The Board agreed that the advisory committee's recommended operational risk disclosure should become an input to the narrative reporting (MD&A) project for which research is being conducted by a partner national standard setter.

*Balance sheet and income statement disclosures*

The Board also discussed three balance sheet and income statement disclosure requirements unrelated to the risk disclosures, These disclosures include: (a) balance sheet amounts based on the measurement basis of the financial asset and/or financial liability (b) income statement amounts based on the measurement basis of the financial asset and/or financial liability and (c) information about the allowance account (this is sometimes also referred to as a "reserve account"), when an allowance account is used instead of taking an impairment adjustment directly against the asset. The Board expressed general support for these disclosure requirements, but requested the advisory committee to develop a principle related to these disclosures and to review the proposed disclosures in light of that principle.

Regarding moving the project forward, the Board agreed that it would be impracticable to incorporate these proposals into IAS 32 in time for them to be applied for 2005 when many companies will adopt IFRS for the first time. Hence, the advisory committee should work on developing a separate Exposure Draft that would replace the financial risk disclosure requirements in IAS 32, and would be effective after 2005, perhaps with earlier adoption permitted or encouraged. In due course, the principles and requirements in the Exposure Draft could be merged with IAS 32 and IAS 39 into a single financial instruments standard.

## First-time application of IFRSs

The Board discussed the comment letters received on ED 1 *First-time Application of International Financial Reporting Standards*, with specific reference to:

- scope
- recognition and measurement
- disclosure
- effective date.

*Scope*

ED1 proposed that its requirements would apply when an entity first adopts International Financial Reporting Standards (IFRSs) as its basis of accounting, by an explicit and unreserved statement of compliance with IFRSs in its financial statements. The Board agreed to retain this proposal, after deleting the reference to the "basis of accounting".

*Recognition and Measurement*

The Board agreed the following changes to the proposals in ED 1:

- The exemption for business combinations should not be mandatory: a first-time adopter need not restate business combinations (even if it uses other exemptions in ED 1), but if it restates any, it must restate all subsequent business combinations as well. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2002, it must restate *all* business combinations that occurred on or after 30 June 2002.
- ED 1 proposed that, if a first-time adopter did not restate a past business combination, assets and liabilities that were not recognised under previous GAAP would have a deemed cost of zero in the first-time adopter's opening IFRS balance sheet. Hence, if IFRSs require a cost-based measurement for those assets and liabilities, they would not be recognised in the opening IFRSs balance sheet.

  However, the Board agreed that the first-time adopter should recognise those assets and liabilities and measure them on the basis that would be required if the acquiree were a first-time adopter at the same time as the acquirer. To illustrate: if the first-time adopter had not, under its previous GAAP, capitalised finance leases acquired in a business combination, it should capitalise those leases based on circumstances existing at inception of the lease.
- IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires an entity to classify some translation differences as a separate component of equity and to recycle the cumulative translation differences (CTD) to the income statement on disposal of the subsidiary in question. ED1 proposed that, if determining the CTD for a foreign operation at the date of transition to IFRSs would involve undue cost or effort, the CTD for that operation under previous GAAP would be the deemed CTD for IFRSs.

  However, the Board agreed that in such cases of undue cost or effort, the entity should be exempt from the requirement to identify the CTD for that subsidiary as a separate component of equity and should not recycle the CTD if it subsequently disposes of the subsidiary. In assessing whether cost or effort would be undue, a first-time adopter should use consistent criteria, to avoid cherry picking (for example, it should not identify CTD only for those subsidiaries with cumulative translation gains and ignore those with cumulative losses).
- Appendix B to ED 1 proposed that a first-time adopter should not recognise negative goodwill in its opening IFRS balance sheet. This would be consistent with proposals in ED 3 *Business Combinations*, but not with existing requirements in IAS 22 *Business Combinations*. The Board agreed not to create a specific exemption from IAS 22 for negative goodwill in the project on first-time application. Instead, the Board would deal with this issue as a consequential amendment when it finalises an IFRS based on ED 3.

Copyright © 2002 International Accounting Standards Committee Foundation 

The Board agreed the following refinements and clarifications to the proposals in ED 1:

- To clarify the treatment of subsidiaries that were not consolidated under previous GAAP (because they were exempt from consolidation or not regarded as subsidiaries under previous GAAP, or the parent did not prepare consolidated financial statements). The entity should adjust the subsidiary's carrying amounts to comply with IFRSs as if it were a first-time adopter at the same date as the parent. The deemed cost of goodwill equals the difference between:
  - (a) the parent's interest in those carrying amounts and
  - (b) the carrying amount in the parent's own financial statements of its investment in the subsidiary.
- To clarify that the business combinations exemption also applies to associates and joint ventures.
- To clarify what happens if intangible assets are transferred to goodwill because they do not qualify for separate recognition, and goodwill was debited to equity under previous GAAP: the transfer from intangible assets should also be debited to equity. Also, this treatment applies if the business combination was treated as a pooling under previous GAAP.
- To clarify the treatment of contingent consideration for past business combinations, of subsequent adjustments to the measurement of assets and liabilities acquired in a past business combination and of the goodwill of foreign operations.
- To confirm that the previous GAAP carrying amount of goodwill arising in a past business combination is not restated to exclude in-process research and development acquired in that business combination.
- To add some discussion to the IFRS on the meaning of undue cost or effort, based on paragraph BC13 of the Basis for Conclusions.
- To clarify that the exemption for cumulative translation differences includes translation differences relating to associates, joint ventures and related hedges.

*Disclosure*

The Board agreed the following changes to the proposals in ED 1:

- To delete the requirement that if the first IFRS financial statements include more than one year of comparative information, the additional comparative information shall comply with IFRSs. Instead, if an entity presents comparative information under previous GAAP, as well as the comparative information required by IAS 1, the entity shall (a) label it prominently as not being prepared under IFRSs and (b) disclose the nature of the main adjustments that would make the data comply with IFRSs.
- As a consequence, to change the definition of the date of transition to IFRSs to: "the beginning of the earliest ~~comparative~~ period ~~presented~~ <u>for which an entity presents full comparative information under IFRSs</u> in <u>its</u> ~~an entity's~~ first IFRS financial statements" [changes marked].

*Basis for conclusions*

The Board noted the staff's proposals for amendments to the Basis for Conclusions:

- The reason for the exemptions relating to event-driven remeasurements and previous GAAP revaluations is relevance to users, rather than undue cost or effort.
- Conform BC66 (which refers to unwinding of the discount on decommissioning liabilities) to IG 10 (which does not).

*Implementation guidance*

The Board noted the staff's proposals for amendments to the implementation guidance:

- Clarify in the introduction to the implementation guidance that (a) it addresses only those IFRSs and Interpretations for which guidance on the interaction between those IFRSs and Interpretations and this IFRS would be helpful and (b) most of it assumes an entity will elect to use the exemptions.
- Confirm the need for consistency in assessing undue cost or effort (already mentioned in paragraph BC 37 of the Basis for Conclusions).
- For intangible assets, include material based on paragraph BC74, which says: "In other cases, an entity may have accumulated and retained sufficient information about costs and future economic benefits to determine which internally generated intangible assets qualify under IAS 38 for recognition in its opening IFRS balance sheet. In such cases, the information is available without undue cost or effort and no exclusion is justified."
- For intangible assets, clarify that IAS 38 paragraph 59 refers only to financial statements or interim financial reports prepared under IFRSs (as opposed to previous GAAP). Thus, a first-time adopter would recognise internally generated intangible assets in its opening IFRS balance sheet if it accumulated and retained sufficient information about costs and future economic benefits to determine which qualify for recognition under IAS 38.
- Clarify that paragraphs 25-27 and IG1-2 do not override requirements in other IFRSs that refer to circumstances that existed at the time of decisions about initial recognition (such as equity/liability classification, lease classification at inception and the IAS 38 restrictions on the use of hindsight for capitalising internally generated intangibles).
- Clarify how the remeasurement of assets and liabilities affects the related minority interest and deferred tax.
- Include an illustrative example of the required reconciliation of equity and profit or loss.

*Effective date*

The Board agreed that an entity should apply the IFRS if its first IFRS financial statements are for a period beginning on or after 1 January 2004 (not 2003, as ED 1 proposed). Earlier application would be encouraged.

*Next steps*

The Board will discuss the following in early 2003:

- clarification of the staff's proposals for dealing with the specific exemption for some subsidiaries (paragraph 5 of ED 1);
- how first-time adopters should treat financial instruments; and
- structure and style of the document.

The Board will then determine whether to direct the staff to prepare a draft of a final IFRS.

 Copyright © 2002 International Accounting Standards Committee Foundation

## IFRIC matters

The Board discussed issues for which the IFRIC or the IFRIC's Agenda Committee has sought guidance. The issues discussed were:

- possible amendments to SIC-12, *Consolidation – Special Purpose Entities*
- IAS 36 *Impairment of Assets*: the inclusion/exclusion from value in use of cash flows expected to arise from a future restructuring
- IAS 12 *Income Taxes*: various deferred tax issues
- IAS 1 *Presentation of Financial Statements*: what should be included in operating/ordinary activities.

In addition, the Board was given a memorandum on various issues on hyperinflation that the IFRIC has discussed, with a view to giving input into the Board's Convergence Project and Improvements Project.

**Possible amendment to SIC-12 *Consolidation – Special Purpose Entities***

The Board has a project on consolidation policies and practices, including their application to special purpose entities (SPEs). This project is likely to result in a replacement of both [draft] IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities* in due course. However, a final Standard is unlikely to be issued for some time.

In its October 2002 meeting, the Board asked the IFRIC to explore in the short-term whether it could make a limited amendment to SIC-12. The amendment would clarify that a 'majority' of benefits or risks (in SIC-12 paragraphs 10(c) and 10(d)) is intended to refer to exposure to the majority of the variability of expected economic outcome, rather than the absolute economic outcome. One aim of making such an amendment would be to converge towards the approach the FASB has been developing in its project on SPEs.

In its November 2002 meeting the IFRIC concluded that it should not recommend an amendment to SIC-12. The IFRIC noted a variety of reasons, including:

- SIC-12 is not interpreted, in practice, as referring to absolute economic outcome, so the limited amendment proposed would likely have little, if any, practical effect and its exposure would, in isolation, be difficult.
- The FASB's approach is still being finalised and its outcome should be considered before any amendments are made to SIC 12 or discussions are taken in the consolidations project.

The Board agreed with the IFRIC's observation, but also thought there was merit in the IFRIC communicating its view about how SIC was being interpreted. This could be achieved in the same manner as for other issues that the IFRIC chooses not to deal with by formal interpretation.

**IAS 36 *Impairment of Assets*: The inclusion/ exclusion from value in use of cash flows expected to arise from a future restructuring.**

IAS 36 requires impairments to be recognised and measured by comparing the carrying value of an asset or cash-generating unit with its recoverable amount. Recoverable amount is the higher of net selling price and value in use. Value in use is the present value of the cash flows expected to arise from the assets, or cash-generating units, continuing use.

Paragraph 37 of [draft] IAS 36 *Impairment of Assets* requires the cash flows in the value in use calculation not to include cash flows that are expected to arise from:

(a) a future restructuring to which an enterprise is not yet committed, or

(b) future capital expenditure that will improve or enhance the asset in excess of its standard of performance assessed immediately before the expenditure is made.

The IFRIC's Agenda Committee considered whether the IFRIC should consider two issues related to this restriction on the cash flows to be included in value in use. The Board agreed with the IFRIC Agenda Committee that the resolution of these issues would require an amendment to IAS 36. Because of this, and because the Board is already amending IAS 36 as part of its project on business combinations, these issues would be better addressed directly by the Board. It noted, however, that any amendments to IAS 36 in this area were not simply consequential from its project on business combinations.

**IAS 12 *Income Taxes*: Various deferred tax issues**

The IFRIC Agenda Committee sought guidance from the Board as to whether it should add six deferred tax issues to its agenda. Three of the issues concerned whether, and how, entities should apply the exemption from recognising deferred tax on initially recognising assets and liabilities; two concerned the recognition of deferred tax in connection with equity instruments; and one was a specific application issue.

Although the Board recognised that some of these issues require swift resolution, it also noted that the Board's short-term Convergence Project could have an impact on all of the issues identified. As the Board is scheduled to discuss the scoping of the convergence work on IAS 12 *Income Taxes* in January or February 2003, the Board should consider the issues identified at that time. The Board noted that, should the Board choose not to address these issues, it might ask the IFRIC to do so.

***IAS 1: Presentation of Financial Statements*: what should be included in operating/ordinary activities**

The IFRIC Agenda Committee asked the Board whether the IFRIC should address an issue that has arisen in practice on what may be included in the line items "the results of operating activities" and "profit or loss from ordinary activities" in the income statement. The Agenda Committee noted that several companies were seeking to exclude 'bad news' from these line items so as to present their results in a more favourable light. The Agenda Committee also noted that although the Board has proposed, in the Improvements to IAS 1, to remove the requirements to present these line items, companies still seek to present such line items because, for example, companies law in a particular jurisdiction may require this.

The Board agreed that the IFRIC should give guidance, in particular on the types of items that would not be included in operating activities and ordinary activities.

**Hyperinflation**

The IFRIC raised the following issues for the Board to consider in relation to its Improvements and Convergence Projects:

- The potential absence of guidance on accounting for high inflation in the context of the proposed withdrawal of IAS 15 *Information Reflecting the Effects of Changing Prices.*
- Determining when an economy is hyperinflationary.

Copyright © 2002 International Accounting Standards Committee Foundation

- Practical matters relating to the application of IAS 29 *Financial Reporting in Hyperinflationary Economies*.

The Board agreed to discuss these items as part of its forthcoming deliberations on the Convergence Project and Improvements Project, particularly, in the context of the comments analyses for IAS 15 and IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

## Improvements to existing IFRSs

The Board considered comments received on the following two standards of its exposure draft (ED)of proposed Improvements to International Accounting Standards IAS 27 *Consolidated and Separate Financial Statements*, and IAS 28 *Accounting for Investments in Associates*.

**IAS 27 *Consolidated and Separate Financial Statements***

The Board considered comments on questions 1 and 3[4] asked in the Invitation to Comment to the ED for IAS 27.

> Question 1
>
> *Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?*

The Board confirmed its proposal that a parent need not present consolidated financial statements to comply with IFRSs provided the criteria in [draft] IAS 27 paragraph 8 are met.

The Board decided that the exemption should be made available when any intermediate parent above the exempted parent prepares consolidated financial statements.

The Board considered the practical difficulties of obtaining unanimous agreement of minority shareholders for non-consolidation. The Board decided that the exemption would be available to a parent that has informed minority shareholders and provided that none of these shareholders have objected to the fact that consolidated financial statements are not prepared.

The Board confirmed that such exempted parents would be required to account for their investments in associates using the equity method as per paragraph 8A in [draft] IAS 28.

The Board instructed the staff to clarify in the revised standard the wording of paragraphs 8(b)[5] and 8(c)[6] in the exposure draft to address commentators' concerns.

> Question 3
>
> *Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39,* Financial Instruments: Recognition and Measurement*, in the investor's separate financial statements (paragraph 29)?*
>
> *Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?*

The Board considered comments received on its proposal regarding the accounting treatment of investments in subsidiaries, jointly controlled entities and associates in the separate financial statements of an investor when separate financial statements are presented. The Board reminded constituents that IFRSs do not mandate the presentation of such separate financial statements.

The Board confirmed that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39 in the investor's separate financial statements.

The Board confirmed that when such investments are accounted for in accordance with IAS 39 in the consolidated financial statements, they should be accounted for in the same way in the investor's separate financial statements.

**Other issues**

*Consolidation of investments in subsidiaries made by venture capital organisations or similar entities*

The Board confirmed that a subsidiary should not be excluded from consolidation based on the nature of the controlling entity, that is whether it is a venture capital organisation, mutual fund, unit trust or similar entity. The Board noted that the principles for consolidation in IAS 27 are not based on a majority ownership at 50 per cent but are built on the concept of control and that control was defined in a manner that includes the power to exercise control, irrespective of whether that power is actually exercised.

The Board noted, in view of comments raised in submissions received, that the existing IAS 27 exemption from consolidation based on temporary control may have been misread or interpreted leniently. In the light of this, the Board acknowledged that a number of entities would face transitional problems in applying the standard for at least some of their investments. In view of these practical difficulties, the Board decided that the effective date for the revised IAS 27 should be financial periods beginning on or after 1 January 2005, with earlier application encouraged.

*Exemption from consolidation based on temporary control*

Additional guidance

The Board decided to include a requirement in the standard that management should be actively seeking a buyer for a subsidiary excluded from consolidation because control is intended to be temporary and the subsidiary is held with a view to its subsequent disposal within 12 months from acquisition.

The Board decided to specify in the standard that when management did not dispose of a subsidiary within 12 months from acquisition, the subsidiary should be consolidated as of the date of acquisition under the standard for Business Combinations with restatement of appropriate prior periods.

The Board decided that the 12 months presumption could be rebutted when relevant regulatory approvals have yet to be received or the relevant regulator has granted a longer timeframe for the disposal of a subsidiary.

Divergence with US GAAP

The Board noted that the exemption from consolidation based on temporary control has been deleted from US GAAP and instructed the staff to monitor any divergence between the requirements in IFRSs and US GAAP.

---

[4] Comments received on question 2 in the Invitation to Comment for IAS 27 were presented at the November 2002 meeting.

[5] 'Its securities are not publicly traded' (proposed paragraph 8 (b)

[6] 'It is not in the process of issuing securities in public securities markets,…' (proposed paragraph 8 ( c).


Copyright © 2002 International Accounting Standards Committee Foundation

*Potential voting rights and allocation of ownership interests*

The Board decided to include additional guidance in the revised standard to assist preparers when considering the existence and effect of potential voting rights and allocation of ownership interests in order to assess whether an entity controls another entity. The Board decided that this guidance should be based on the examples in SIC-33 *Potential Voting Rights and Allocation of Ownership Interests* Appendix A.

**IAS 28 *Accounting for Investments in Associates***

The Board considered comments received on the two questions asked in the Invitation to Comment to IAS 28 and on other issues raised by respondents.

> Question 1
>
> *Do you agree that IAS 28 and IAS 31* Financial Reporting of Interests in Joint Ventures *should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS 39* Financial Instruments: Recognition and Measurement *when such measurement is well-established practice in those industries (see paragraph 1)?*

The Board confirmed its decision that venture capital organisations and similar type entities that measure investments, which would otherwise be associates or joint ventures, at fair value, should not account for these investments under the equity method or proportionate consolidation method in IAS 28 and IAS 31, but report these investments at fair value in the financial statements.

The Board confirmed that whenever investments that would otherwise be associates or joint ventures are measured at fair value in the financial statements, changes in fair value should be reported in the income statement.

The Board considered commentators' concern that in some jurisdictions local GAAP may have precluded the emergence of a well-established practice to measure these investments at fair value. Therefore, the Board decided that the availability for venture capital organisations and similar type entities to measure investments that would otherwise be associates or joint ventures at fair value should not be subject to the existence of a well-established practice in those industries.

> Question 2
>
> *Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long-term receivables (paragraph 22)?*

In light of submissions received, the Board decided to clarify that:

- the amount to be reduced to nil when an associate incurs losses should include only long term interests, which are in substance part of the net investment
- the investor applies the requirements of IAS 39 to determine whether any additional impairment loss is recognised with respect to that net investment, and
- the investor applies the requirements of IAS 39 to determine whether any impairment loss is recognised with respect to items that are not part of the net investment.

The Board agreed that receivables for which good collateral existed, like secured loans, should not be included in the amount to be reduced to nil when an associate incurs losses.

**Other issues**

*Non-coterminous year ends*

The Board considered commentators' concerns regarding the practical difficulties of the Board's requirement that when the financial statements of an associate are not as of the same reporting date as the investor, the difference between the two reporting dates should be no greater than three months.

The Board instructed the staff to present at a future meeting a proposal to address these concerns.

## Income Statement (reporting performance)

The Board discussed a draft Exposure Draft of a proposed IFRS ('Draft ED').

A number of specific issues were raised, on which the Board tentatively decided:

- the total column should be presented first rather than last, in order to emphasise that it includes all income and expenses and that the other two columns are disaggregations of the total.
- subsets of comprehensive income (for example, with labels such as 'operating earnings' or 'trading profit') should only be displayed on the face of the statement when they are subtotals of other amounts displayed on the face – that is, a subset cannot be reported if it is not the sum of other amounts displayed in the statement.
- the reporting of per share amounts should be considered at a future meeting, in particular whether such amounts are meaningful unless numerators are adjusted for minority interests and tax.
- discontinuing activities should be reported separately in the statement. The Board asked the staff to consider further how this might be done and whether the presentation should be net of tax (that is, separate from business, financing and income taxes).

The Board discussed proposed extensions/ applications of the Draft ED, including a proposal to include, within business activities, a separate section relating to items of income and expense that are reported net. The staff will bring an analysis of this proposal to a future meeting.

## Revenue recognition

The Board discussed whether, under an assets and liabilities approach to revenue recognition, an entity should recognise revenues (and related expenses) with respect to the performance of its obligations to customers if a third party performs them on its behalf. In discussing this issue, the Board considered the decisions of the FASB's Emerging Issues Task Force in:

- Issue No. 99-19 *Reporting Revenues Gross as a Principal versus Net as an Agent*
- Issue No. 00-10 *Accounting for Shipping and Handling Fees and Costs*
- Issue No. 01-14 *Income Statement Characterization of Reimbursements Received for "Out-of-Pocket" Expenses Incurred*.

In Issue No. 99-19, the EITF specified criteria for determining whether an entity should recognise revenue based on (a) the gross amount billed to a customer because it has earned revenue from the sale of the goods or services (the "gross method") or (b) the net amount retained (that is, the amount

Copyright © 2002 International Accounting Standards Committee Foundation

billed to a customer less the amount paid to a supplier) because it has earned a commission or fee (the "net method").

In Issue No. 00-10, the EITF specified that amounts billed to a customer in a sale transaction related to shipping and handling should be recognised as revenue because those billings relate to the provision of the goods.

In Issue No. 01-14, the EITF specified that reimbursements received by an entity for out-of-pocket expenses incurred should be recognised as revenue.

The Board considered whether, under an assets and liabilities approach, an entity should recognise revenues only with respect to the activities that it performs itself. In some cases, applying that policy might lead to different outcomes than under the "either gross or net" approach (depending on the circumstances) adopted by the EITF.

The Board tentatively agreed that it should explore further a policy that an entity should recognise revenues only with respect to the activities that it performs itself. The Board also tentatively agreed that this policy needs further parameters, and guidance will be necessary on what constitutes performance and revenue-generating activities. For example, more parameters are needed if the following circumstances are to be distinguished from each other:

- An entity transfers to a third party its contractual obligations to provide goods or services to customers (in which case the entity does not recognise revenue for the provision of those goods or services).
- An entity "sub-contracts" third parties to provide goods or services to customers and those parties are regarded as acting on the entity's behalf (in which case the entity recognises revenue for the provision of those goods or services).

The Board was concerned that an implication of the papers considered might be that revenue would be dissected in some transactions between multiple suppliers in a vertically integrated process culminating in the delivery of goods or services to customers. If this implication was correct, the Board was concerned as to how far to take the dissection.

Examples of contractual arrangements that may need consideration in analysing this issue are:

- A car manufacturer contracts a third party to supply an engine for particular models of its cars.
- A retailer sells goods to customers for which the manufacturer warranties the goods against defects. It sells some of these items from its own stock, and orders others to be supplied directly from the manufacturer to its customers.
- A travel agent arranges the sale of airline tickets to its customers.

The Board noted that future agenda papers will consider whether the identity of the parties to a revenue arrangement that bear particular risks should determine which entities recognise revenue for particular goods and services provided to customers. For example, the Board will consider whether, in the sale of products to customers, it is relevant who bears the product defect risk, general inventory risk, physical loss or damage inventory risk, price risk, credit risk and refund risk. In addition, the Board tentatively agreed to consider whether the above-mentioned issues with applying a "performance of activities" based approach to revenue recognition could be addressed by focusing on the nature of the assets that are controlled by the vendor and applying the Board's policy for the derecognition of assets.

## Meeting dates: January – December 2003

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

22 – 24 January 2003

19 – 21 February†

Week of 10 March – public roundtables on IAS 32 and IAS 39§

19 – 25 March

24 April – 2 May‡

21 – 23 May

16 – 20 June†, Rome, Italy

23 – 25 July

17 – 23 September‡

22 – 24 October, Toronto, Canada

17 – 21 November†

17 – 19 December

§ Meeting venues to be confirmed – see www.iasb.org.uk

† Includes a meeting with the Standards Advisory Council

‡ Includes a meeting with partner national standard-setters


Copyright © 2002 International Accounting Standards Committee Foundation