BOARD DECISIONS ON INTERNATIONAL ACCOUNTING STANDARDS

IASB UPDATE

July 2002

The International Accounting Standards Board met in London 16-19 July 2002, when it discussed:

- Business combinations
- Consolidation and special purpose entities
- Convergence of accounting standards
- Deposit-taking, lending and securities transactions
- Insurance contracts
- Reporting performance
- Share-based payment.

Business combinations (phase I)

The Board discussed the treatment in the draft IFRS prepared for phase I of the project of liabilities that arise as a consequence of a business combination. Examples include contractual obligations of the acquiree to its employees under which payments to the employees are triggered as a result of a combination. Such arrangements are sometimes referred to as 'golden parachutes'. The Board had previously agreed that such obligations represent post-combination expenses of the combined entity. Therefore, they should not be recognised by the acquirer either as part of the cost of the combination or as part of allocating that cost.

In reconsidering this issue, the Board concluded that a payment an entity is contractually required to make in the event that it is acquired in a business combination is an unrecognised contingent liability of that entity until it becomes probable that a business combination will occur. Under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, that obligation should be recognised as a liability by the entity when a business combination becomes probable and the liability can be reliably measured. Thus, when the combination occurs, the liability will be recognised by the acquirer as a liability assumed as part of allocating the cost of the combination.

The Board agreed to amend the draft IFRS accordingly.

Business combinations (phase II)

Recognition and measurement issues related to acquired assets and assumed liabilities in a business combination

In June 2002, the Board agreed to a fair value hierarchy for determining the initial amounts to be recorded at the date of acquisition for identifiable assets acquired and liabilities assumed in a business combination. In July 2002, the Board considered, and will consider at future meetings, a number of circumstances in which additional implementation guidance might be necessary to ensure consistent application of the fair value hierarchy. Some of these circumstances relate to exceptions to fair value measurement. Others relate to changes from current practices that require additional clarification to ensure consistency with the working principle.

Scope

The Board noted its earlier decision to exclude from this project issues related to the initial recognition and measurement of the acquiree's income tax assets and liabilities and assets and liabilities arising from post-employment benefits. Those items, while recorded as part of the business combination, are not subsumed in the working principle and would not be measured at fair value. The recognition and measurement principles in IAS 12 *Income Taxes* would continue to apply to those income tax assets and liabilities. The recognition and measurement principles in IAS 19 *Employee Benefits* would continue to apply to assets and liabilities arising from post-employment benefits.

Measurement when the occurrence of a business combination affects the fair value of the acquired item

The Board considered the measurement of items whose fair value might be affected by the occurrence of a business combination.

The Board discussed the role of credit rating in measuring the fair value of liabilities assumed in a business combination and, in particular, it considered whether on initial recognition the fair value of an assumed liability should reflect (a) the credit rating applicable to a liability of the acquiree before the combination or (b) the credit rating applicable to a liability at the date of acquisition in the combined entity's financial statements.

The Board tentatively agreed that application guidance should be provided in the IFRS on Business Combinations, explaining that the fair value of a liability assumed by the acquirer in a business combination should be based on prices observed in recent market transactions for similar liabilities with a credit rating similar to that applicable to the liability assumed at the date of acquisition. If market prices are not observable, the fair value of liabilities assumed should be estimated using valuation techniques. These techniques should incorporate the appropriate discount rate relevant to the credit rating applicable to the liability at the date of acquisition. That credit rating will reflect any effect of the business combination such as the assumption of the liability by the acquirer or the provision of an explicit or implicit guarantee.

Measurement of post-employment benefit obligations assumed in a business combination

The Board discussed some limited issues relating to the initial measurement of the acquiree's post-employment benefit

(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,
7th Floor, 166 Fleet Street, London, EC4A 2DY
United Kingdom
Tel: +44 (0)20 7427 5927
Fax: +44 (0)20 7353-0562
E-mail: publications@iasb.org.uk

ISSN 1474-2675

Business combinations (phase II) (continued)

obligations under IAS 19, including whether, and in what circumstances, the business combination itself affects the measurement of the post-employment benefit obligations.

The Board considered the following circumstances:

- The acquirer has a different assessment of future events from the acquiree's and therefore uses different actuarial assumptions in estimating the acquiree's post-employment benefit obligation.
- The terms of the post-employment benefit plan to be provided by the acquirer will differ from the terms of the acquiree's benefit plan because it is expected that the acquirer will (a) change the plan of the acquiree to provide benefits to employees of the acquiree that are compatible with the benefits provided to its own employees, (b) curtail or terminate the plan of the acquiree or (c) otherwise restructure the plan of the acquiree.
- The acquirer will amend the post-employment benefit plan as a condition of the business combination agreement with the owners of the acquiree.

The Board tentatively agreed that the measurement of a post-employment benefit obligation assumed should be based on the actuarial assumptions of the acquirer at the date of acquisition. The Board indicated that it is necessary to distinguish clearly and accurately in the draft IFRS on Business Combinations (phase II) such changes to the actuarial assumptions from changes to the actual terms of the plan.

The Board agreed that any changes to the terms of the plan that are contemplated by the acquirer should not affect the measurement of the post-employment benefit obligation at the date of acquisition. Instead, any effect of the changes should be considered as post-combination expenses of the combined entity. Changes to the terms of the acquiree's post-employment benefit plan should be reflected in the measurement of the post-employment benefit obligation at the date of acquisition only if those changes are made before the acquisition date.

Further, the Board concluded that when amendments to the acquiree's post-employment benefit plan (usually improvements) are a condition of the business combination, the liability associated with those amendments that is attributable to services rendered by the participants of the plan before the acquisition date:

- is not a liability or contingent liability of the acquiree at the acquisition date
- should not be regarded as a liability assumed in exchange for assets given, liabilities incurred, and equity instruments issued by the acquirer.

The Board concluded that obligations that are triggered by the business combination itself represent post-combination expenses of the combined entity.

Constructive obligations

The Board considered the treatment of constructive obligations that arise as a result of the business combination that were not liabilities of the acquiree before the business combination (for example, the cost associated with restoring contaminated land of the acquiree that was not a constructive obligation of the acquiree but which, because of an established pattern of past practice, would be a constructive obligation of the acquirer). The Board concluded that a constructive obligation that arises as a result of the business combination:

- is not a liability or contingent liability of the acquiree at the acquisition date
- should not be regarded as a liability assumed in exchange for assets given, liabilities incurred, and equity instruments issued by the acquirer.

The Board then considered the treatment of a constructive obligation that is an existing liability of acquiree but which would not be a constructive obligation of the acquirer after the business combination. The Board concluded that such a constructive obligation should be recognised as part of recognising the assets acquired and liabilities assumed in the combination. However, the fair value of that liability at the acquisition date would be close to zero.

Recognition criteria for assets acquired and liabilities assumed in a business combination

The Board considered the role of probability and reliable measurement recognition criteria for identifiable assets acquired and liabilities assumed in a business combination.

The Board concluded that the probability recognition criterion need not be included in the draft IFRS for assets acquired and liabilities assumed, because the acquirer is required to recognise those items at their fair values as the acquisition date. The fair value reflects market expectations about the probability that future economic benefits associated with the assets acquired and liabilities assumed will flow to or from the acquirer. In other words, the effect of probability is reflected in the fair value measurement of the assets acquired and liabilities assumed. However, the Board agreed that the reliable measurement criterion should be retained.

The Board also considered application guidance for determining whether an asset acquired or liability assumed in a business combination can be reliably measured.

The Board tentatively agreed that the IFRS arising from phase II should include the following guidance:

- Except in extremely rare cases, an acquirer would be able to measure the fair values of assets acquired and liabilities assumed in a business combination.
- When there is a range of possible outcomes with different probabilities, that uncertainty enters into the measurement of the fair value of an asset or a liability rather than demonstrates an inability to measure reliably.
- Valuation methods or techniques should deal with uncertainty about the amount and timing of the future cash flows. Expectations about possible variations in the amount or timing of those cash flows and the price for bearing the uncertainty inherent in an asset or a liability enter into determining the fair value of the assets or liability.

Consolidation and special purpose entities

The Board discussed consolidation policy, and its application to special purpose entities (SPEs), and made the following tentative decisions:

General principles

- Consolidation policy should be driven by the principle of reporting on economic entities.
- The borders of economic reporting entities should be determined by the same control notion that underpins the definitions of the assets.

Copyright © 2002 International Accounting Standards Committee Foundation

- In deciding which entities should be part of reporting entities, that is, be consolidated, control should be defined in terms of the capacity to control in order to benefit. Exercise of that capacity is not required. The definition of control for the purposes of consolidation may be different from that for individual assets.
- Consolidated financial reports should reflect the entities that are controlled at the balance sheet date. For example, the Board agreed that control could exist where a shareholding of less than 50 per cent is held and the remaining shares are widely dispersed among passive holders. Non-consolidation should not be allowed simply because dispersed shareholders could coalesce in the future.
- Options to buy shares are one of the factors to be considered in determining whether there is control of an entity. For example, if Company A owns 100per cent of the shares in Company B and Company C holds currently exercisable options over all of the shares in Company B, Company C rather than Company A would, in the absence of other factors, consolidate Company B.
- Minority interests are equity contributors to the economic entity. This does not negate the case for separate disclosures of their interests.
- When an entity is acquired and there is an intention or obligation to resell the interests in that entity, consolidation of the assets of the acquired entity may not be appropriate. This may arise since an obligation to resell has the effect that the relevant controlled asset is the net investment, rather than the underlying individual assets and liabilities. Care will need to be exercised in determining when this principle might be made operational.
- Only one entity can control another entity.
- Restrictions on the control of assets can raise questions of non-recognition/derecognition or impairment.

Special purpose entities

- The Board wishes to prepare a comprehensive standard covering consolidation of both non-SPEs and SPEs.
- Consistent criteria should be developed for all entities, whether or not SPEs and whether passive, rather than excluding certain categories of entities from application of the provisions.
- The Board agreed generally with the circumstances identified in the FASB's proposed interpretation in which traditional means of identifying the existence of control may not assist.
- When the existence of control is not obvious using traditional methods , the Board also agreed with the FASB that control should be determined by examining the variable interests of participants.
- In order to determine which entity should consolidate, consideration must be given to the order of loss, the size of the potential loss exposure and the benefits applicable to each party's interests.
- Application of the principles may result in no entity consolidating an SPE.
- Interaction of the consolidation requirements with leasing and derecognition criteria needs to be examined. The Board agreed that it does not follow that derecognition means non-consolidation, but some entities that are controlled may have little in the way of assets (because they have been dispersed to other participants). In this light, the Board did not see the need to exempt QSPEs from consolidation.

Next steps

A meeting will be held between representatives of the Board, the FASB, Germany's DRSC, and the UK's ASB in late July 2002 to discuss consolidation issues. A project plan will be presented to a subsequent Board meeting.

Convergence

The Board continued its consideration of comparisons of IASs with requirements under national generally accepted accounting principles with a view to identifying where convergence might be achieved in a relatively short time. The Board agreed that the national standard-setters should be asked to consider the comparisons and identify areas where they also could start their own convergence work. Proposed action could be discussed at the meeting with national standard-setters in October 2002.

The Board agreed that it would discuss with the US FASB at a joint meeting in September 2002 those areas that could be tackled as joint projects and establish an appropriate timetable for those projects. The Board would then be able discuss with other national standard-setters what progress towards convergence could be achieved by the end of 2004.

The Board made the following observations on specific standards.

- [Draft] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*: the Board noted that it had considered convergence issues during the Improvements project and had proposed those changes it thought appropriate. An issue that remained was the distinction, if any, between changes in estimates (which are accounted for prospectively) and changes in accounting principles (which are accounted for retrospectively under [draft] IAS 8 and via a cumulative 'catch-up' adjustment recognised in current income under US GAAP). There are issues that national standard-setters might wish to consider, for example the disclosures required for significant accounting policies; the Board should communicate such items to the other national standard-setters.
- IAS 16 *Property, Plant and Equipment*: the Board concluded that the alternative to revalue property, plant and equipment is too fundamental an issue to consider as a discrete convergence project. The revaluation group was considering differences in the approach taken to revaluation of tangible and intangible assets in those jurisdictions that permit it. The question of whether the proposal in the Improvements project that some subsequent expenditures should be treated as separate components for purposes of depreciation caused a divergence from US GAAP would be investigated.
- IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*: the deferred recognition of grants in income was an issue that should be considered as a matter of priority.
- IAS 21 *The Effects of Changes in Foreign Exchange Rates*: significant differences between IAS 21 and other national standards were:
  - on disposal of a foreign operation, some jurisdictions require the recognition in income of exchange differences previously recognised directly in equity (that is, on disposal the exchange differences are recycled from equity to income). The issue of recycling was being addressed in the project on reporting performance.
  - the translation of foreign operations in hyperinflationary economies. This issue would be considered along with the comparison of IAS 29 and equivalent national accounting requirements that will be brought to the September 2002 Board meeting.
- IAS 31 *Financial Reporting of Interests in Joint Ventures*: at its June 2002 meeting, the Board directed the Staff to

prepare a paper for the meeting with national standard-setters in October 2002 considering the possibility of removing the allowed alternative of proportionate consolidation. There were also differences in the definitions of joint ventures that could be considered as part of a convergence project.

- IAS 33 *Earnings per Share*: the Improvements project proposals should eliminate significant differences in this area. However, the earnings figure to be used in the earnings per share calculation was an issue that would have to be considered in the reporting performance project.
- IAS 36 *Impairment of Assets*: there were fundamental differences in the approach to impairment across national accounting standards and IAS 36. The issue was being considered as part of the research project on measurement led by the Canadian Accounting Standard Board. The comparative analysis would be forwarded to the AcSB Staff.
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*: the Board agreed that changes to IAS 37 would need to be considered in the light of the conceptual project on the definition and measurement of liabilities, rather than as a discrete convergence project.
- IAS 38 *Intangible Assets*: there were major differences in the costs that may be capitalised under IAS 38 and under US GAAP. However, the Board concluded that this was too fundamental an issue for it to be considered as a discrete convergence project.

Convergence: post-employment benefits

The Board considered the discussion at the June 2002 Standards Advisory Council meeting on the post-employment benefit convergence project and agreed to proceed with the project.

The Board considered the recognition of actuarial gains and losses and noted that immediate recognition of all actuarial gains and losses might not be consistent with the recognition of past service costs over the vesting period. There may be actuarial gains and losses relating to unrecognised past service costs and it might be consistent not to recognise such gains and losses. The Board agreed to consider this issue further at a subsequent meeting.

A majority of the Board agreed that actuarial gains and losses should be recognised immediately. However, the Board noted that it would not be possible to proceed with a standard based on this conclusion until the project on reporting performance had finalised its proposals on the presentation of the actuarial gains and losses.

Deposit-taking, lending and securities activities

The Board had a preliminary discussion of the proposals for disclosure and presentation of financial assets, financial liabilities, income and expenses resulting from deposit-taking , lending and securities activities, as well as disclosure relating to financial risks associated with such activities.

The Board expressed concern over the volume of disclosures that could result in some circumstances. It discussed some of the similarities in the areas of risks to be disclosed with the existing requirements of IAS 32 *Financial Instruments: Disclosure and Presentation*. It agreed to ask the project's Advisory Group to consider the interaction between the proposed financial risk disclosures and the requirements of IAS 32, and whether a common set of principles for disclosure could be developed for all entities to apply. Under this approach, some of the disclosure requirements in IAS 32 might need revision or clarification, and some of the more detailed disclosures proposed in the project might form application guidance.

The Board discussed the line items proposed on the face of the balance sheet and the face of the income statement, and, given that the scope of the project was wider than the scope of IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, the interaction with the requirements of IAS 1 *Presentation of Financial Statements*, IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement*. Some members were uncertain why certain line items were proposed, when existing Standards already required disclosure of similar amounts in the notes to the financial statements. The Board agreed to ask the Advisory Group to reconsider what, if any, line items should be presented on the face of the balance sheet and the income statement.

The Board also discussed more detailed issues and provided the following guidance to the Staff and Advisory Group:

- the definition of a securities activity (which currently included buying, holding and selling financial instruments within the scope of IAS 39, except for certain instruments) may be too wide;
- the separate financial statements of a parent or wholly-owned subsidiary that are made available or published with consolidated financial statements should not be excluded from the disclosures relating to financial risks;
- if the disclosure of certain sub-classifications for line items presented on the face of the balance sheet is useful to understanding the credit quality of an entity's assets, it should be integrated with the other disclosures relating to credit risk;
- when an entity undertakes a securities activity for which it has fiduciary responsibilities, the aggregate amount of financial assets involved should be disclosed;
- disclosure of the extent to which an entity's exposure to credit risk is protected by collateral pledged as security or any other credit enhancements should not be required;
- the Advisory Group should consider further whether to use expected or contractual maturity dates when disclosing minimum quantitative information about liquidity risk in light of the guidance in IAS 32; and
- the Advisory Group should reconsider the proposal to disclose the weighted average effective interest rate for each major currency in which financial instruments are denominated.

The Board also had a preliminary discussion of the proposals to amend IAS 1 for disclosure of information about operational risk and solvency risk. The Board provided the following guidance to the Staff and Advisory Group:

- disclosure of information about operational risk and compliance with imposed financial requirements relating to solvency risk may be more appropriate in a discussion by management outside the financial statements. The Advisory Group is to continue developing the disclosures for input to the topic of the financial aspects of Management's Discussion and Analysis, which is being considered by a partner national standard-setter;
- the definition of operational risk – the risk of loss due to inadequate or malfunctioning internal processes, people and systems, or due to external events – should be clarified in order to remove any possibility of overlap with the other types of risks;
- the distinction between solvency risk and liquidity risk requires clarification; and

Copyright © 2002 International Accounting Standards Committee Foundation

- disclosure of information about any self-imposed financial requirements relating to solvency risk (for example, internal rates of return for business units) should not be required. The Advisory Group should consider limiting the disclosure of information about any externally imposed financial requirements to situations when a regulator imposes such requirements.

Insurance contracts

The Board discussed a series of examples of life insurance economics and accounting. The session was primarily informational and no decisions were taken.

Reporting performance

The Board continued its discussion of cash flow hedges, focusing on the problems caused when income or expenses on hedging instruments arise in periods different from those on hedged items.

Four alternative approaches were considered:

- 'direct to equity' with recycling when the hedged future transaction affects income, which is the existing approach under IAS 39
- no recycling, whereby all income and expenses are recognised once only and cash flow hedge accounting is in effect prohibited, the method most consistent with the Board's focus on comprehensive income and its working principles
- 'quasi-recycling', whereby income and expenses on hedging instruments are reported in a separate 'cash flow hedging' category, and subsequently 'recycled' within the statement of comprehensive income into the same functional line item as the hedged item
- basis adjustment, whereby income and expenses on hedging instruments are deferred in the balance sheet until recognition of the hedged item.

The Board agreed that only the 'no recycling' approach was consistent both with the *Framework* and a single statement of comprehensive income. It also agreed, however, that this issue was part of a much larger project eventually to reconsider accounting for financial instruments. It was beyond the scope of the reporting performance project. As a compromise solution, a majority of the Board favoured 'quasi-recycling', while a minority favoured the direct to equity approach. 'Quasi-recycling' was inconsistent with the *Framework* because it permitted amounts that are neither income nor expense of the current period to influence the display of comprehensive income in the current period. While the Board stated its intention to consider cash flow hedge accounting at a later date, in the meantime 'quasi-recycling' was a practical method for maintaining both a single statement of comprehensive income and cash flow hedge accounting.

The Board also tentatively agreed that there should be a separate cash flow hedging category within both the operating and financing sections in the performance statement and that there should be no distinction within the statement of changes in equity or the balance sheet between retained earnings and any notional cash flow hedge reserve. In addition, 'quasi-recycling' should be allowed for the special case of cash flow hedges only and no other recycling in the performance statement would be permitted.

The Board discussed other aspects of the project and reached a tentative conclusion that the Staff should prepare a summary paper on the project, to be discussed at meetings of the Board, national standard-setters and Standards Advisory Council in September, October and November 2002 respectively. These discussions would be followed by field visits to users and preparers. In addition, the project should move directly to an exposure draft, without first issuing a discussion paper, with a target date for the release of Q1 2003. The final output from the project would include amendments to IAS 1 (and possibly to the *Framework*), a new IFRS and consequential amendments to existing standards.

Share-based payment

The Board discussed the accounting treatment of employee share options, with the objective of reaching some overall conclusions, taking into account the Board's previous discussions of all relevant accounting and valuation issues. The Board also received a report on a panel discussion recently held in New York City, co-hosted by representatives of the IASB. A panel of experts discussed the valuation of employee share options, including the Board's tentative conclusions thereon and confirmed that the Board had identified and considered all the important measurement issues raised by share-based payment transactions.

The Board tentatively concluded:

- The IFRS should require a fair value measurement method to be applied to all types of share-based payment transactions, including all types of employee share-based payment.
- Therefore, the IFRS should not follow the same approach as US accounting requirements. In other words, entities should not be permitted a choice between a fair value measurement method and an intrinsic value measurement method, and should not be permitted a choice between recognition and disclosure of expenses arising from employee share-based payment transactions.

The Board then discussed some detailed accounting and measurement issues. For options with reload features, the Board tentatively concluded that the reload feature should be included in the grant date estimate of the fair value of the option. However, if the reload feature is not included in the grant date estimated fair value (for example, because it was not apparent at grant date that the options had a reload feature), then when the reload option is granted, it should be accounted for as a new option grant.

The Board also discussed the possibility that some options might have very complex features, which make it difficult to estimate their fair value. The Board tentatively agreed that there should be no exceptions to the requirement to apply a fair value measurement method. Therefore, failing to comply with that requirement would represent a departure from the IFRS. The Board tentatively agreed that, in this situation, the entity should disclose why it has been unable to estimate the fair value of the options.

The Board also tentatively agreed that the scope exclusion in SIC-16 *Share Capital – Reacquired Own Equity Instruments (Treasury Shares)* for treasury shares purchased, sold, issued or cancelled in connection with employee share/option plans should be removed once an IFRS on share-based payment comes into effect. However, if SIC-16 has been withdrawn and incorporated into a revised IAS 32 *Financial Instruments: Disclosure and Presentation* by the time the IFRS comes into effect, the IFRS should state that the requirements in the revised IAS 32 regarding treasury shares also apply to treasury shares purchased, sold, issued or cancelled in connection with employee share plans and other share-based payment arrangements.

The Board discussed the definition of grant date. It tentatively agreed that grant date should be defined as the date when an

Copyright © 2002 International Accounting Standards Committee Foundation

agreement has been reached between the entity and its employees (or other parties) that will entitle the employees (or other parties) to receive shares, options or other equity instruments issued by the entity, provided the specified vesting conditions, if any, are met. The Board also tentatively agreed that if the share/option plan is subject to an approval process (for example, shareholder approval), grant date is the date when that approval is obtained.

For share-based payment transactions measured at the fair value of the goods or services received, the Board tentatively agreed that fair value should be estimated at the date of receipt of those goods or services.

The Board also tentatively agreed that the IFRS should contain application guidance on the valuation implications of dividends paid during the period between grant date and exercise date.

The Board discussed the accounting treatment of share/option plans that are cancelled during the vesting period (other than individual cancellations caused by the departure of employees). The Board tentatively agreed that the entity should continue to account for services received during the vesting period, using the grant date, fair value measurement method. Any cash payment made to employees on the cancellation of the share/option plan should be debited to equity as the repurchase of an equity interest. If the entity considers a new option grant to be replacement options for the cancelled options, the entity may account for the granting of replacement options in the same way as a repricing, that is, recognise additional remuneration expense for the incremental value granted, being the difference between the fair value of the replacement options and the fair value of the cancelled options, at the date the replacement options are granted.

The Board also discussed consequential amendments to other standards, and tentatively agreed that when the IFRS becomes effective:

- the section on equity compensation benefits in IAS 19 *Employee Benefits* should be deleted
- the scope exclusions in IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement* should be modified to exclude rights and obligations arising from transactions falling within the scope of the IFRS on share-based payment.

The Board continued its discussion of an issue relating to share plans with cash alternatives, previously discussed at its June 2002 meeting. The Board tentatively concluded that for such share plans where the entity has the choice of settlement and where no liability arises, the transaction should be measured based upon the grant date fair value of the equity instruments' alternative and recognised over the vesting period, in the same manner as other forms of equity-settled share-based payment transactions. The Board also tentatively agreed that the circumstances in which a liability would arise include where the entity has a past practice or a stated policy of settling in cash. Irrespective of whether a liability arises on grant date, on settlement the entity should disclose whether it has settled in cash or by issuing equity instruments.

The Board also discussed the tax effects of share-based payment transactions. It tentatively agreed that *all* tax effects should be included in the income statement. Also, in situations where the tax deduction is made in a later accounting period, a deferred tax asset/liability should be recognised between grant date and the date when the tax deduction is made, determined in accordance with the measurement basis used for tax purposes. For example, if the amount of the tax deduction is based on the option's intrinsic value at exercise date, the deferred tax asset/liability recognised between grant date and exercise date should be based on the option's intrinsic value at each balance sheet date. The Board tentatively agreed that a worked example to explain and illustrate the Board's tentative conclusions should be included in the Exposure Draft, as a consequential amendment to IAS 12 *Income Taxes*.

The Board reconsidered and confirmed its previous tentative conclusion that the liability recognised between grant date and settlement date for cash-settled share-appreciation rights (SARs) should be measured using a fair value measurement basis. The Exposure Draft should include a worked example illustrating this.

The Board discussed transitional arrangements and the effective date of the IFRS, and tentatively agreed:

- For equity-settled share-based payment transactions, the IFRS should require limited retrospective application, to outstanding shares/options that were granted after the date on which the ED is published that have not vested at the time the standard becomes effective.
- For all existing liabilities arising from cash-settled share-based payment transactions, the IFRS should require full retrospective application.
- The standard should be effective for financial statements covering accounting periods beginning on or after 1 January 2004, provided that the final IFRS is issued before the end of 2003.
- The ED should state the likely effective date (as above).
- The IFRS should state that early adoption is encouraged.
- For first-time adopters of IFRSs, there should be a consequential amendment to the IFRS on first-time application to require:
  - limited retrospective application for outstanding shares/options that were granted after the date on which the ED is published that have not vested at the date of transition to IFRSs.
  - full retrospective application for all existing liabilities arising from cash-settled share-based payment transactions.

The Board also tentatively agreed that the worked example on accounting for the tax effects of share-based payment transactions should include an example for entities applying the standard for the first time.

The Board directed the Staff to begin drafting an Exposure Draft, based on the Board's tentative conclusions to date.

The Chairman conducted an informal poll of the Board, to determine whether any Board members were considering dissenting from the issuance of the Exposure Draft. No Board members indicated that they were considering such a dissent.

Meeting dates: August – December 2002

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

18 – 20 September, Norwalk, Connecticut, USA

23 – 29 October‡

12 – 16 November, Hong Kong SAR, China†

18 – 20 December

† Includes a meeting with the Standards Advisory Council

‡ Includes a meeting with partner national standard-setters

Copyright © 2002 International Accounting Standards Committee Foundation