

The International Accounting Standards Board met in London on 18-20 February 2004, when it discussed:

- Business combinations
- Consolidation
- Disposal of non-current assets and presentation of discontinued operations
- Financial instruments
- IAS 20 *Government Grants and Disclosure of Government Assistance*
- IFRIC issues
- Insurance contracts
- Post-employment benefits
- Revenue recognition
- Small and medium-sized entities

## **IAS 39 *Financial Instruments: Recognition and Measurement*: the fair value option**

The Board discussed the concerns raised by regulators regarding the use of the "fair value option" in IAS 39 *Financial Instruments: Recognition and Measurement*, ie the permission to designate any financial asset or financial liability, irrevocably on initial recognition, as one to be measured at fair value with changes in fair value recognised in profit or loss.

The Board considered the reasons behind introducing the fair value option and concluded that such an option did simplify implementation of IAS 39. However, it also noted the concern raised by regulators that the fair value option may be used inappropriately.

Accordingly, it tentatively decided that whilst preserving the key benefits of the option it would explicitly limit the use of the option to specified situations. The Board tentatively decided to allow the use of the fair value option in the following situations:

- (a) The item is a financial asset or financial liability that contains one or more embedded derivatives as described in IAS 39 paragraph 10.

(b) The item is a financial liability whose amount is contractually linked to the performance of assets that are measured at fair value.

(c) The exposure to changes in the fair value of the financial asset or financial liability is substantially offset by the exposure to the changes in the fair value of another financial asset or financial liability, including a derivative.

The Board also noted that some entities might wish to use the fair value option for financial assets in cases other than the three set out above. Such entities include investment trusts and venture capital entities for which industry practice is to measure all financial assets at fair value through profit or loss. Such entities also include some insurance companies that hold financial assets whose fair value exposure partly offsets that of insurance liabilities measured using techniques that incorporate some market-consistent data but not at fair value. To address these situations, the Board tentatively decided to allow the use of the fair value option for any available-for-sale financial asset other than a loan or receivable. It discussed two ways to achieve this. The first is to allow the fair value option to be applied, by designation on initial recognition, to any available-for-sale financial asset other than a loan or receivable, on an asset-by-asset basis. The second is to restore the permission in the original IAS 39 for an entity to elect, as an accounting policy choice, to recognise in profit or loss gains and losses on all available-for-sale assets. The Board will continue its discussion of this issue at a future meeting.

In addition the Board tentatively decided to emphasise in IAS 39 that the fair value option could be used only for items whose fair value is verifiable, and to note that the application of the fair value requirements of IAS 39, in a manner consistent with the entity's risk management policies and objectives, may be subject to the oversight of a prudential supervisor. It also tentatively decided that the condition contained in

IAS 39 requiring the irrevocable election of the fair value option upon initial recognition would still apply.

The Board asked the staff to prepare a draft of the proposals to modify the fair value option as set out above. The Board tentatively decided to publish these proposals as an Exposure Draft.

## **IAS 36 *Impairment of Assets***

The Board raised a concern about a change that was made to IAS 36 as a consequential amendment by IAS 16 *Property, Plant and Equipment* (2003). That amendment related to the future cash flows to be included in the determination of value in use. The concern was that the revised wording could be interpreted as prohibiting an entity from including future costs necessary to maintain the level of economic benefit expected to arise from an asset in its current condition, and the related cash inflows. The Board agreed that this was not the intended effect of the consequential amendment and directed the staff to revise the wording to clarify that the application of the previous Standard was unchanged.

Copyright © IASB Update is published immediately after every IASB meeting by the International Accounting Standards Board,  
30 Cannon Street,  
London EC4M 6XH, United Kingdom  
Email: [iasb@iasb.org](mailto:iasb@iasb.org)  
Website: [www.iasb.org](http://www.iasb.org)

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

## Business Combinations (phase II)

---

### Treatment of non-identifiable non-monetary assets without physical substance in a business combination

In October 2003, the Board considered some examples of items that might meet the proposed revised definition of a contingent asset, including:

- a conditional right that arises from an in-process legal claim against a competitor through the courts ('legal claim'), and
- a conditional right that arises from an application for an operating licence ('licence application').

The Board observed at that meeting, and again at this meeting, that for each of these examples, there are two elements: an unconditional (or non-contingent) element and a conditional (or contingent) element. The Board concluded that the unconditional element gives rise to an asset that would, if it were acquired in a business combination, meet the contractual-legal criterion, and possibly the separability criterion, for identification as an intangible asset separately from goodwill. The Board also concluded that the conditional element gives rise to a contingent asset, and that this conditional element should not, in a business combination, be recognised as an asset separately from goodwill. The Board observed, however, that the conditional element would affect the fair value measurement of the unconditional element.

At this meeting, the Board considered whether a significant contract in the process of being negotiated between the acquiree and a customer with whom the acquiree has had no prior contractual relationship ('pending customer contract') meets the proposed definition of a contingent asset. The Board concluded that it did. An entity that is negotiating a contract has conditional rights relating to the contract, because those rights are dependent on whether the parties will agree on the terms of the contract. The Board then considered whether, as with the legal claim and the licence application, there also existed *unconditional* rights arising from the pending contract that would qualify in a business combination for identification as an intangible asset separately from goodwill.

The Board decided that the pending customer contract does not give rise to rights that would qualify for recognition at the acquisition date separately from goodwill, and therefore that any economic value associated with that pending contract would be part of goodwill. In the absence of a business combination, the developing relationship between the two parties would be an asset that is in the nature of internally generated goodwill. Similarly, if an acquiree were, at the acquisition date, in the process of negotiating a contract, any economic value of the developing relationship between the acquiree and its customer would be an asset that is in the nature of acquired goodwill. This is because the pending contract is not an identifiable asset at the acquisition date because it does not, at that date, meet the contractual-legal rights or separability criteria in IAS 38 *Intangible Assets* for identification as an intangible asset<sup>1</sup>.

---

<sup>1</sup> This presumes that the developing relationship could not, at the acquisition date, be transferred to another party. If a pending contract were transferable, it would be separable and therefore meet the criteria for identification as an intangible asset and, provided its

The Board observed that if the contract were finalised after the acquisition date, the value of the pending contract would continue to be subsumed in goodwill—the Board previously decided that goodwill should not be adjusted for the effects of events after the acquisition date. The Board expressed concern over the potential this might create for abuse. Therefore, the Board discussed whether, as an exception to the principle of not adjusting goodwill for the effects of events after the acquisition date, the fair value of a pending contract should be credited to goodwill with the corresponding recognition of an intangible asset (ie the contract) in some limited circumstances.

The Board concluded that there should be no exceptions to the principle. However, it noted that the situation at the acquisition date should be carefully considered to determine whether legally enforceable rights existed even though the contract had not been formally signed.

The Board also continued its consideration of the definitions of contingent assets and contingent liabilities and their treatment both in and outside of a business combination. The Board directed the staff to prepare a summary articulating clearly the implications of the Board's analyses of these issues.

## Consolidation (including special purpose entities)

---

The Board continued its discussion of the concept of control as the basis for consolidation.

The Board discussed the circumstances in which holdings of potential voting rights (such as holdings of unexercised options or convertible instruments that give the holder the right to obtain instruments that may enable them to dominate policy determination) are relevant to a present assessment of the *power* criterion<sup>2</sup>.

The staff proposed that holdings of potential voting rights are relevant to the assessment of power when the holder has a unilateral ability to exercise or convert at any time. The staff suggested that this condition would be satisfied if the following were met:

- the options or convertibles may be exercised immediately (ie not reliant on the further passage of time or the occurrence of a future event).
- there are no impediments to exercise, such as exercise being contingent on regulatory approval. (However, a current lack of sufficient financial resources to enable exercise or conversion would not be viewed as an impediment to exercise.)
- the option has commercial substance (it is not, for example, set at a strike price that is artificially high so that exercise is not possible in any foreseeable circumstances, rather than being simply out of the money).

The Board decided in principle that holdings of potential voting rights are relevant to a present assessment of power when, as a result, the holder has the ability to dominate policy determination. However, the Board did not decide on the

---

fair value can be reliably measured, be required to be recognised in a business combination separately from goodwill.

<sup>2</sup> Being the ability to dominate an entity's strategic operating and financing policy.

particular circumstances in which such holdings should be included.

The Board also discussed how the holdings of ‘straw men’ or *de facto* agents (being entities that act as an effective agent for another investor) should be treated in assessing an entity’s ability to satisfy the power criterion.

The Board tentatively decided that entities that fall within one or more of the following categories are straw men for an investor:

- (a) the investor’s related parties as defined in IAS 24 *Related Party Transactions*;
- (b) an entity that received its interest in the investee as a contribution or loan from the investor;
- (c) an entity that has an agreement that it cannot sell, transfer or encumber its interests in the investee without the prior approval of the investor;
- (d) an entity that cannot finance its operations without financial support from the investor;
- (e) employees of the investor;
- (f) an entity that has a close business relationship with the investor (like that between a professional service provider and one of its significant clients); and
- (g) an entity with the same board of directors as the investor’s.

The Board noted that categories (e) and (f) should be refined to include only those entities highly likely to be dominated by the investor. For example, *except* in the case of special purpose entities, (e) should be restricted to senior management and it should be clarified that (f) is not intended to capture ‘standard’ business relationships such as that between a customer and its suppliers.

The Board tentatively decided that the exposure draft of the consolidation draft standard should include a rebuttable presumption that the holdings of straw men (as listed above) should be assumed to be available to an investor in assessing whether that investor meets the power criterion, subject to evidence that those holdings are in fact not effectively held as agent for that investor.

## Disposal of non-current assets and presentation of discontinued operations

The Board continued from its January 2004 meeting the discussion about the classification of a discontinued operation. The Board also considered issues identified as a result of its review of the pre-ballot draft of the IFRS.

### Classification as a discontinued operation

ED 4 proposed that a discontinued operation should be a component of an entity (ie operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity) that either has been disposed of, or is classified as held for sale, and

- the operations and cash flows of that component have been, or will be, eliminated from the ongoing operations of the entity as a result of its disposal, and
- the entity will have no significant continuing involvement in that component after its disposal.

Many respondents questioned whether the proposed definition of a discontinued operation would result in decision-useful information and expressed cost/benefit concerns. At its January 2004 meeting, the Board decided that it wished to distinguish

between the disposal of *assets* or groups of assets and the discontinuance of an *operation*.

At this meeting, the Board considered the following alternatives:

- Retaining the proposal in ED 4 and, based on the material developed to date by the US Emerging Issues Task Force, provide additional guidance on the definition of a discontinued operation.
- Adopting a definition based on the concept of a business that the Board developed for its Business Combinations (phase I) project.
- Using the definition from IAS 35 *Discontinuing Operations* but moving the timing of the classification of an operation as discontinued to be consistent with the timing of the classification of assets as held for sale.

The Board observed that none of the options was ideal. Retaining the proposal in ED 4 would converge with US GAAP; however, the EITF material was not sufficiently developed to be incorporated into the IFRS. On the other hand, proceeding with the approach in ED 4 without additional guidance would ignore problems experienced in the US with the proposed definition. The Board also noted that basing the definition of a discontinued operation on a *business* was untested and would not converge with US GAAP. Therefore, the Board decided that, in the interim, the IFRS should retain the definition from IAS 35 (ie a component should represent a separate major line of business or geographical area of operations) but should converge with SFAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* on the timing of the classification.

The Board also decided that it should continue to seek full convergence on this issue and should therefore work with the FASB to explore further the definition of a discontinued operation.

### Current/non-current classification

Some respondents had questioned whether the definition of a current asset in paragraph 57 of IAS 1 *Presentation of Financial Statements* could be interpreted as excluding from the scope of ED 4 some assets classified as held for sale. IAS 1 states that an asset “expected to be realised within twelve months after the balance sheet date” should be classified as current. If a non-current asset has been reclassified as ‘current’ before the asset meets the criteria for classification in ED 4 as held for sale, the asset would not be within the scope of the IFRS.

The Board decided to clarify in the IFRS how the classification ‘held for sale’ interacts with the definition of current assets in IAS 1, ie to specify that assets that are classified as non-current assets should not be reclassified as current until they meet the criteria for classification as held for sale. Further, assets of a class that the entity would normally regard as non-current and are acquired exclusively for resale should be classified as current only if they meet the criteria for classification as held for sale.

### Associates and joint ventures

Associates and joint ventures acquired and held exclusively for resale are currently accounted for in accordance with IAS 39 in both consolidated and separate financial statements. Therefore, they are excluded from the scope of ED 4. Some respondents had questioned this scope exclusion.

The Board noted that associates and joint ventures that are held for sale should be treated in the same way regardless of whether they meet the criteria for classification on initial recognition or at a later date. The Board also noted that the criteria that apply to investments in associates and joint ventures acquired and

held exclusively for resale should be the same as the criteria for classification as held for sale in the IFRS.

Therefore, the Board decided to delete from IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* the requirements relating to associates and joint ventures acquired and held exclusively for resale and add requirements in the IFRS for associates and joint ventures that meet the criteria to be classified as held for sale. The Board observed that this would be consistent with its decision in January 2004 to remove the exemption from consolidation for subsidiaries acquired and held exclusively for resale. In relation to removing that exemption, the Board decided to include in the IFRS an example illustrating that a full line-by-line consolidation is not required and that computational short-cuts can be used to determine the two-line presentation in the balance sheet, which is required for a disposal group classified as held for sale.

## Fair value hedge accounting for a portfolio hedge of interest rate risk

### Hedge effectiveness

The Board discussed the application of the effectiveness tests in IAS 39 *Financial Instruments: Recognition and Measurement* to a portfolio hedge of interest rate risk.

IAS 39 paragraph AG105 states that a hedge qualifies for hedge accounting only if it meets both of the following conditions:

- (a) it is expected to be highly effective (the 'prospective effectiveness test'). This will be the case only if it is expected that the changes in the fair value or cash flows of the hedging instrument will "almost fully offset" those of the hedged item arising from the hedged risk.
- (b) it is determined actually to have been highly effective (the 'retrospective effectiveness test'). This will be the case if the actual results of the hedge are within an 80-125 per cent range.

It is common for entities entering into a macro hedge to hedge prepayable items with non-prepayable derivatives. The Board's decision in January 2004 that the change in the fair value of the hedged item that is attributable to interest rate risk includes any effect that interest rates have on prepayment rates. Thus, ineffectiveness will result on such a hedge. Respondents to the Exposure Draft noted that the resulting ineffectiveness might be so large that either or both of IAS 39's effectiveness tests would not be met.

The Board considered the following issues raised by respondents to the Exposure Draft:

- (a) Should IAS 39's effectiveness tests apply to a macro hedge?
- (b) How should IAS 39's effectiveness tests be applied to a macro hedge?
- (c) Should the Board change or clarify IAS 39's effectiveness tests?

#### *Should IAS 39's effectiveness tests apply to a macro hedge?*

The Board noted that one of the principles of hedge accounting is that the hedge is highly effective, and that its objective in this project is to simplify the application of fair value hedge accounting to a macro hedge in a way that meets these principles. Accordingly, the Board decided to clarify in the Standard that IAS 39's effectiveness requirements apply to a macro hedge. In other words, the proposals in the Exposure Draft are not an alternative to, and do not override, IAS 39's effectiveness tests.

#### *How should IAS 39's effectiveness tests be applied to a macro hedge?*

The Board discussed the effect on the application of the prospective effectiveness test of the entity's periodic adjustment of the amount of the hedging instrument to reflect changes in the hedged item ('rebalancing' a hedge). It decided to clarify in the Standard that if the entity's risk management strategy is to change the amount of the hedging instrument periodically to reflect changes in the hedged position, that strategy affects the determination of the terms of the hedge. Thus the entity must demonstrate that the hedge is expected to be highly effective only for the period until the amount of the hedging instrument will next be adjusted.

The Board also discussed whether, for a macro hedge, the retrospective effectiveness test should be assessed for all maturity time periods in aggregate or individually for each maturity time period. The Board decided that entities could use either method (or a combination of the two). The method used is specified as part of the documentation of the hedging relationship at the inception of the hedge and hence is not specified at the time the retrospective effectiveness test is performed.

#### *Should the Board change or clarify IAS 39's effectiveness tests?*

The Board noted that the issues set out below go beyond macro hedging, and affect the assessment of effectiveness for all hedges.

The Board decided to clarify in the Standard that an expectation of high effectiveness can be demonstrated in various ways including:

- a comparison of past changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk with past changes in the fair value or cash flows of the hedging instrument (unless there is reason to believe that the past is not predictive of the future) or
- by demonstrating a high statistical correlation between the fair value of cash flows of the hedged item and those of the hedging instrument based on the hedge ratio that maximises the effectiveness of the hedge.

The Board also discussed whether to relax the prospective effectiveness test from "almost fully offset" to "80-125 per cent". The Board noted the main arguments for making such a change. It also considered the concern previously expressed by the Board that if the "almost fully offset" test were relaxed, an entity might deliberately under-hedge in a cash flow hedge to reduce reported ineffectiveness. The Board tentatively decided:

- to remove the words "almost fully offset" from IAS 39's prospective effectiveness test, and replace them by a requirement that the hedge is expected to be "highly effective" (ie the same words as in US GAAP).
- to include a statement in the Application Guidance in IAS 39 that if an entity hedges less than 100 per cent of the exposure on an item, such as 85 per cent, it shall designate the hedged item as being 85 per cent of the exposure and shall measure ineffectiveness based on the change in that designated 85 per cent exposure.

The Board discussed whether further clarification is required about how to apply the retrospective effectiveness test when the hedged item is designated as a portion of a hedged item, and on what qualifies as a 'portion' in accordance with IAS 39. The Board tentatively decided to clarify in the Standard that:

- when the hedged item is designated as a portion, ineffectiveness should be measured by looking at changes in the fair value or cash flows of only that designated portion (and not changes in the fair value or cash flows of all of the hedged item).

- if an entity designates a portion of the exposure on a financial asset or financial liability, that designated exposure must be less than the total exposure inherent in the asset or liability. For example, for a liability whose interest rate is below LIBOR, an entity cannot identify a LIBOR portion and a negative residual portion. However, if a fixed rate financial instrument is not hedged at its origination and interest rates have changed in the meantime, the entity can designate a portion that is greater than the contractual rate paid on the item. For example, if an entity originates a financial asset of CU100 that pays a fixed rate of 6 per cent when LIBOR is 4 per cent, and begins to hedge that asset later when LIBOR is 8 per cent and the fair value of the asset is CU80, the entity can designate the asset as containing a LIBOR portion of 8 per cent that consists partly of contractual interest cash flows and partly of the unwinding of the difference between the present fair value (CU80) and the amount repayable on maturity (CU100).
- An entity can designate any portion that is smaller than the total exposure on the hedged item, regardless of whether that portion is highly correlated with the pricing of the hedged item. For example, an overdraft issued by a European bank can be viewed as containing a LIBOR portion (so long as the rate charged on the overdraft is above LIBOR) even though the overdraft rate is not highly correlated with LIBOR.

### Amortisation

The Board considered when and how entities should amortise the separate balance sheet line item in either assets or liabilities that arises as a result of using fair value hedge accounting for a portfolio hedge of interest rate risk. The line item contains the effective part of the change in the fair value of the hedged item.

The Board considered the following three scenarios.

- (a) There is no change, during the life of the hedge, in the amount of the asset designated as being hedged and the corresponding hedge ratio. Based on this scenario, the Board noted that when there is no change in the designated hedged amount, no amortisation of the line item balance is required.
- (b) The amount of the asset designated as being hedged is reduced during the life of the hedge (eg because the entity originates new liabilities) with a corresponding change in the hedge ratio, but the assets continue to be held. The Board noted that when the designated hedged amount is reduced but the item is still held, amortisation is required of that part of the line item balance that relates to the amount of the reduction (ie to the amount that is no longer hedged).
- (c) The amount of the asset designated as being hedged is reduced during the life of the hedge because some of the asset is derecognised (eg through sale), with a corresponding change in the hedge ratio. The Board noted that when the designated hedged amount is reduced because some of the item has been derecognised, no amortisation of the line item balance is required because a portion of the line item is derecognised at the same time.

The Board then discussed the method of amortisation to be used when amortisation is required. The Board noted that IAS 39 (paragraph 92) requires an amortisation method based on a recalculated effective interest rate. However, for a macro hedge such a method could be complex to apply and could require significant systems capabilities. Therefore, the Board tentatively decided that for macro hedges, the line item balance should be amortised:

- (a) when practicable, on the basis of a recalculated effective interest rate, and

- (b) when not practicable, using a straight-line method.

The Board also tentatively decided to retain the proposal in the Exposure Draft that the balance of the line item should be amortised over the period during which the assets or liabilities to which it relates are derecognised.

### Transition

The Board discussed how entities should make the transition to the new requirements for fair value hedge accounting for a portfolio hedge of interest rate risk. The Board tentatively decided:

- to add application guidance stating that an entity wishing to apply fair value hedge accounting to a portfolio hedge that has been accounted for using cash flow hedge accounting should apply IAS 39 paragraph 101(d) to discontinue cash flow hedge accounting, and designate a new fair value hedge for future accounting periods.
- not to permit a fair value macro hedge to be designated retrospectively.
- not to give explicit guidance for entities that wish to apply fair value hedge accounting for their macro hedges where possible, but do not meet the conditions to do so for all maturity time periods. The usual requirements in IAS 39 for discontinuing fair value (or cash flow) hedge accounting and for re-designating a hedge should apply.
- to require entities to consider the amendments for macro hedging and the revised IAS 39 issued in December 2003 as a single document for the purposes of transition. In other words, an entity cannot adopt the amendments for macro hedging early without also adopting the rest of the revised IAS 39 and the revised IAS 32.

### Other issues

The Board considered various other issues raised by respondents. As decided in December 2003, the Board members assigned to the project discussed these issues before the Board meeting and proposed a resolution based on these discussions. The Board tentatively decided to clarify in the Standard the wording used in the Exposure Draft.

### Next steps

The Board has concluded its redeliberation of the Exposure Draft. The staff will now prepare a pre-ballot draft for the Board's consideration, with the intention of issuing the revisions to IAS 39 in March 2004. No Board members have indicated an intention to dissent to the Standard.

## ***IAS 20 Government Grants and Disclosure of Government Assistance***

In December 2003, the Board reaffirmed its earlier decision to replace IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

The Board has previously considered various options for replacing the Standard, including adopting accounting models at present prescribed by pronouncements of other standard-setting bodies. However, in the light of the ongoing work on revenue recognition, the Board decided that it would be premature to specify a new model. It also agreed that withdrawing IAS 20 would leave constituents with insufficient guidance. Therefore, the Board tentatively decided to amend IAS 20 by adopting the accounting model for government grants contained in IAS 41 *Agriculture*. This model currently applies only to biological assets measured at fair value less estimated point-of-sale costs.

The Board noted that this would mean replacing the recognition requirements of IAS 20 with the principles from IAS 41 paragraphs 34-36. This would result in an unconditional grant being recognised as income when the grant becomes receivable and a conditional grant being recognised as income when the conditions attaching to the government grant are met.

The Board directed the staff to draft the amendments to IAS 20 for its consideration at a future meeting.

## IFRIC issues

### IFRIC Interpretation on multi-employer plans

The Board considered a draft IFRIC Interpretation on multi-employer plans that the IFRIC had approved for publication. The Interpretation includes a proposed amendment to IAS 19 *Employee Benefits* relating to state plans.

The Board approved the proposed amendment to IAS 19 and did not object to the publication of the draft Interpretation. The Board suggested that IFRIC should include in the invitation to comment an additional question on the accounting treatment proposed for those participants in multi-employer plans that are able to apply defined benefit accounting.

## Insurance Contracts (phase I)

In January 2004, the Board approved an IFRS on insurance contracts, subject to written ballot. At this meeting, the Board discussed the following issue that arose during the preparation of the written ballot.

The issue relates to a financial guarantee contract that meets the definition of an insurance contract and was not incurred or retained on transferring financial assets or financial liabilities to another party. Financial guarantees can have various legal forms, such as that of a financial guarantee, letter of credit, credit default contract or insurance contract. The Board previously concluded that the accounting for these instruments should not depend on their legal form.

A financial guarantee meets the definition of an insurance contract if it requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument, provided that the resulting risk transfer is significant. If a financial guarantee contract does not meet the definition of an insurance contract, it is within the scope of IAS 39.

ED 5 proposed that such contracts should be subject to the same requirements as all other insurance contracts. However, the Board decided in finalising the recent amendments to IAS 39 that the issuer should initially recognise a financial guarantee contract at fair value, and subsequently measure it at the higher of (a) the amount recognised under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*. The issuer is subject to the derecognition provisions of IAS 39. In January, the Board reaffirmed that decision and concluded that all similar contracts should be accounted for that way.

At this meeting, the Board:

- confirmed the decision made in January 2004, but concluded that this change to the proposals in ED 5 requires re-exposure. The Board directed the staff to develop an Exposure Draft reflecting this decision.

- decided that the IFRS should, pending amendments resulting from that Exposure Draft, treat these contracts in the same way as other insurance contracts (as proposed in ED 5).

The Board will complete the written ballot on the IFRS after this meeting and expects to issue an IFRS in March 2004.

## Post-employment benefits

The Board considered five issues:

- the treatment of group defined benefit plans in the separate financial statements of entities within the group
- whether actuarial gains and losses that are recognised outside the income statement, in a statement of total recognised income and expenses, should be shown in a separate component of equity and not included in retained earnings
- whether, when actuarial gains and losses are recognised immediately, an amount in equity representing the defined benefit asset or liability should be presented separately
- how any adjustment relating to the asset ceiling should be treated when actuarial gains and losses are recognised outside income
- whether the sensitivity information previously proposed by the Board should form part of the short-term amendments.

The Board decided that entities that met the criteria not to present consolidated financial statements in IAS 27 *Consolidated and Separate Financial Statements* should be within the scope of the provisions in IAS 19 *Employee Benefits* relating to multi-employer plans. Other group entities participating in a group defined benefit plan should be required to make a reasonable and consistent allocation of the plan in their separate financial statements.

The Board decided that actuarial gains and losses that are recognised outside the income statement, in a statement of total recognised income and expenses, should not be shown in a separate component of equity and should be included immediately in retained earnings.

The Board decided not to require a separate presentation of the amount in equity representing the defined benefit asset or liability.

The Board decided that, when actuarial gains and losses are recognised immediately outside income in a statement of total recognised income and expenses, the impact of the asset ceiling should be treated as an actuarial gain or loss and, hence, also recognised outside income in a statement of total recognised income and expenses.

The Board decided that the only sensitivity information to be proposed in the short-term exposure draft should be that required under SFAS 132 *Employers' Disclosures about Pensions and Other Postretirement Benefits*, ie sensitivity information relating to medical cost trend rates.

Two Board members noted their intention to present an alternative view in the exposure draft. One Board member was considering presenting an alternative view, subject to the drafting relating to the presentation in equity of actuarial gains and losses recognised outside income.

## Revenue recognition

The Board discussed the consultation process it should follow for its proposed amendments to the IASB *Framework* and IAS 18 *Revenue* resulting from the Revenue Recognition project. The Board noted that decisions made in this project would have implications for other projects and for the review of other Standards. The Board tentatively decided to seek public comment on its proposed concepts and principles before developing exposure drafts of amendments to the *Framework* and IAS 18 *Revenue*.

The Board confirmed that in the Revenue Recognition project, it should continue to use the terms conditional and unconditional to describe contractual rights and obligations. It noted that the meaning of conditional obligations is consistent with its meaning in the proposed definition of “contingent liabilities” tentatively decided by the Board in its limited review of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The Board discussed an initial (and incomplete) set of draft recognition and measurement principles for revenue recognition. It tentatively decided that:

- (a) it does not object to defining a “principle” as a bridge between the concepts in the IASB *Framework* and the higher-level implementation guidance that will be set out in IAS 18.
- (b) the effects of the time value of money and credit risk should be reflected in the fair value of contractual assets unless those effects are immaterial.

The Board deferred making decisions on the draft principles until further papers are prepared on related issues, such as the definition of revenues. The Board provided the staff with drafting suggestions and directions on aspects of the draft principles to consider in preparing a revised draft.

The Board directed the staff to prepare a project plan showing the tentative decisions made, the issues yet to be decided, and the linkages between them.

## Accounting and financial reporting by small and medium-sized entities

The Board discussed a summary of the tentative decisions made with respect to the approach to the SME project and made certain modifications. The Board decided to clarify that the IASB’s SME standards would be suitable only for entities that do not have public accountability. They would not be intended for use by publicly-listed companies, even if national law or regulation were to permit this.

The Board discussed whether an SME should choose either (a) the complete set of IFRSs (full IFRSs) or (b) the complete set of SME standards. In other words, should an SME be permitted to choose, Standard by Standard, principle by principle, from the SME standards and from full IFRSs. The Board did not conclude its discussion on this issue and will consider it further at a subsequent meeting.

After considering a number of possible replacements, the Board decided to continue to use the term “small and medium-sized entity”, rather than an alternative term.

Several decisions require an assessment of the needs of users of financial statements of SMEs in deciding on the appropriate accounting standards for such entities. The Board agreed to consult an informal user group to assess users’ needs.

As modified, the Board’s tentative decisions are:

- Full IFRSs should be regarded as suitable for all entities.
- As an alternative, IASB will develop a separate set of financial reporting standards that is suitable for those entities that do not have public accountability. If IASB SME standards do not address a particular accounting question, the entity would be required to look to the appropriate IFRS to resolve that particular question only. The entity would not be required to revert to full IFRSs.
- The Board should describe the characteristics of SMEs for which it intends the standards. These characteristics should not prescribe quantitative “size tests” but rather consider qualitative factors such as public accountability. National jurisdictions should determine which, if any, entities of particular size or significance should be permitted or required to follow IASB SME standards.
- An entity has public accountability if:
  - There is a high degree of outside interest in the entity from investors or other stakeholders.
  - The entity has an essential public service responsibility due to the nature of its operations.
  - A substantial majority of its stakeholders depends on external financial reporting as they have no other way of obtaining financial information about the entity.
- A business entity would be regarded as having public accountability if it meets any one of the following criteria:
  - It has filed, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.
  - It holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities brokerage, pension fund, mutual fund, or investment banking entity.
  - It is a public utility or similar entity that provides an essential public service.
  - One or more of its owners has objected to the entity’s decision to use SME standards rather than full IFRSs (all owners, including those not otherwise entitled to vote, having been informed of that decision).
- The IASB standards for SMEs should:
  - provide a single set of high quality, understandable, and enforceable accounting standards suitable for SMEs throughout the world
  - reduce the financial reporting burden on SMEs that want to use IASB standards
  - be built on the same conceptual framework as IFRSs
  - allow easy transition to full IFRSs for those SMEs that grow or choose to switch to full IFRSs
  - focus on meeting the needs of users of SME financial statements.
- Development of IASB SME standards should start by extracting the fundamental concepts from the IASB *Framework* and the principles and related mandatory guidance from IFRSs (including Interpretations).
- Any modifications to those concepts or principles must be on the basis of the identified needs of users of SME financial statements and cost/benefit analysis.
- It is likely that disclosure and presentation modifications will be justified based on user needs and cost/benefit analysis. The disclosure modifications could increase or decrease the current level of disclosure.

- There would be a rebuttable presumption that no modifications would be made to the recognition and measurement principles in IFRSs. Such modifications can be justified only on the basis of user needs and a cost/benefit analysis.
- IASB SME standards should be published in a separate printed volume.
- IASB SME standards should:
  - follow the IAS/IFRS numbering system – that is, SME-IAS 1, SME-IAS 2, etc. and SME-IFRS 1, SME-IFRS 2, etc.
  - not be reorganised by topic (such as integrated in a balance sheet - income statement line item sequence like the UK FRSSE).
- Each IASB SME standard should include a statement of objective and an executive summary.
- Each IASB SME standard should explicitly mention the required fallback to full IFRS.

The Board agreed to publish a discussion document setting out its tentative decisions on the approach to the project, with comments invited. The document will include the Board's reasons for those decisions. The Board also asked the staff to develop one or two examples of SME Standards for possible inclusion in the document.

#### **Meeting dates: 2004**

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

17—19 March

21—23; 26, 27 April<sup>†</sup>

19—21 May

21—25 June, Oslo, Norway<sup>†</sup>

20—22 July

22—24; 27, 28 September<sup>†</sup>

18—20 October, Norwalk, Connecticut, USA

15—19 November<sup>†</sup>

15—17 December

<sup>†</sup> Includes a meeting with the Standards Advisory Council

<sup>‡</sup> Includes meetings with partner standard-setters