BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

September 2004

The International Accounting Standards Board met in London on 21-24 September 2004, when it discussed:

- Business combinations
- Exploration for and evaluation of mineral resources
- Financial instruments: the fair value option
- IASB *Framework*
- IASB deliberative process
- IAS 12 *Income Taxes*
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- Post-employment benefits
- Share-based payment
- Small and medium-sized entities

In addition, it met world standard-setters on 27 and 28 September and its partner national standard-setters on 27 and 29 September. Reports of these two meetings will be included in the next issue of *IASB Insight*.

Business combinations (phase I)

The Board considered at this meeting the comment letters received on the Exposure Draft of *Proposed Amendments to IFRS 3* Business Combinations *Combinations by Contract Alone or Involving Mutual Entities.*

The Board noted that the majority of respondents disagreed with the proposals. Their reasons included the following:

- the Board will address the accounting for combinations involving mutual entities or by contract alone without the obtaining of an ownership interest as part of its joint IASB/FASB project on purchase method procedures. There seems little reason for proceeding with an interim solution if it will shortly be replaced by a final standard.
- the 'modified' purchase method proposed in the Exposure Draft is inconsistent with IFRS 3. For example, the proposals would result in three different treatments for goodwill under IFRSs depending on whether the combination was by contract alone without the obtaining of an ownership interest, between two or more mutual entities or otherwise within the scope of IFRS 3. Some respondents believe that existing purchase method procedures could be applied in most cases. Others believe that a 'fresh start' method would be more appropriate than what they think is a flawed modification to the purchase method. Others argued that the pooling of interests method should be retained.
- the proposed 'modified' purchase method would result in a combination involving mutual entities being overstated whenever any consideration given by the acquirer in exchange for control of the acquiree exceeds the amount of goodwill in the acquiree.
- the amendments were being proposed too close to the 2005 deadline for adoption of IFRSs in Europe and other jurisdictions. Such late changes were inconsistent with the Board's stated objective that the body of IFRSs to be applied for 2005 would be finalised by March 2004 and that any changes to IFRS after that date would not be effective until 2006.

In the light of respondents' comments, the Board decided not to proceed with the proposals in the Exposure Draft. Instead IFRS 3 would retain the scope exclusions for combinations involving mutual entities and by contract alone without the obtaining of an ownership interest, pending completion of the joint project on purchase method procedures.

The Board noted the following implications of this decision:

- entities would need to account for combinations involving mutual entities or by contract alone without the obtaining of an ownership interest by applying the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* on developing accounting policies in the absence of a Standard or an Interpretation that specifically applies to a transaction or event.
- in accordance with the requirements in IAS 8, management must use its judgement in developing and applying an accounting policy that results in information that is:
  - relevant to the economic decision-making needs of users; and
  - reliable, including that the financial statements reflect the economic substance of the transaction or event.

  In making this judgement, management must refer to, and consider the applicability of, the requirements and guidance in Standards and Interpretations dealing with similar and related issues, and the definitions, recognition criteria and measurement concepts in the *Framework*. Management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework, other accounting literature and accepted industry practice, but only to the extent that these do not conflict either with the guidance in Standards and Interpretations dealing with similar and related issues or with the *Framework*.

(Continued...)

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Business combinations (phase I) *(continued)*

- in accordance with IAS 8, an entity is precluded from applying a superseded Standard, such as the guidance in IAS 22 *Business Combinations* that was withdrawn in March 2004, when accounting for combinations involving mutual entities or by contract alone without the obtaining of an ownership interest. However, entities would be permitted to look to IFRS 3 for guidance.

Other issues raised by respondents

Combinations by contract alone without the obtaining of an ownership interest

Some respondents were not sure which transactions included in the descriptor 'by contract alone without the obtaining of an ownership interest'. For example, respondents questioned whether the following features would imply that a combination was not by contract alone without the obtaining of an ownership interest:

- *'Stapling' transactions*[1] By legal form these are not 'by contract alone without the obtaining of an ownership interest', because the *shareholders* of each of the combining entities receive, at a notional amount, equity instruments (ie ownership interests) in the other combining entity that are then 'stapled' to their existing shareholdings. However, in economic substance such transactions can be regarded as no different from a dual listing.
- *Cash or other payments* The contractual arrangements underpinning a dual listing or a security stapling often involve transactions in anticipation of the combination, such as one of the combining entities paying 'special dividends' or issuing bonus shares to its existing shareholders immediately before the combination is effected. The purpose of such transactions is to 'equalise' the value of the combining entities' equity instruments immediately before the combination is effected. Are such payments pre-combination in nature or should they be regarded as consideration paid in the business combination?
- *Direct investment in the other combining entity* It is not clear whether a combination could be regarded as 'by contract alone without the obtaining of an ownership interest' when one of the combining entities has a pre-existing ownership interest in the other combining entity, or the combination is *predominantly* by contract while at the same time involving *some* consideration being given by the acquirer for an ownership interest in the acquiree. For example, the formation of a dual listed corporation may, as part of the contractual arrangement, involve the acquirer obtaining a small parcel of shares in the acquiree, but that ownership interest on its own (ie excluding the other terms of the contract) does not give the acquirer control of the acquiree.

The Board observed that 'by contract alone without the obtaining of an ownership interest' was intended to capture (and exclude from IFRS 3) any business combination in which the obtaining of control by one of the combining entities was effected *solely* as a result of contractual arrangements, without the combination itself (ie the bringing together of the separate entities into one reporting entity) involving any of the *combining entities* (as opposed to their shareholders) obtaining an ownership interest in the other combining entity (or entities). The reasons for the proposed exclusion were:

- although identification of the acquirer rests on the notion of control, the purchase method in IFRS 3 is a 'cost allocation' model, with 'cost' being the fair value *given by the acquirer* in exchange for control of the acquiree (plus any costs incurred by the acquirer that are directly attributable to the combination).
- complications arise in applying IFRS 3's version of the purchase method when there is no 'cost' in the traditional sense *given by the acquirer* in exchange for that control.[2]
- a distinction needs to be drawn between reverse acquisitions (for which the Board has developed guidance on applying the purchase method), and other combinations intended to be excluded from IFRS 3 for which there is no 'cost' given by the acquirer in exchange for control. The distinction is that a reverse acquisition involves one of the combining entities, though not the accounting acquirer, obtaining an ownership interest in the other combining entity.

It follows that:

- the stapling transactions referred to by respondents *are* intended to be captured within the term 'by contract alone without the obtaining of an ownership interest'. This is because such combinations are effected by contract without one of the *combining entities* obtaining an ownership interest in the other combining entity.
- the cash or other payments referred to by respondents that are made in anticipation of a dual listing or security stapling are pre-combination in nature—they are not a 'cost' given by the acquirer in exchange for control of the acquiree nor do they result in one of the combining entities obtaining an ownership interest in the other combining entity.
- if a combination is predominantly by contract while at the same time involving some consideration being given by the acquirer for an ownership interest in the acquiree, it is not a combination by contract alone without the obtaining of an ownership interest. This would include, for example, the formation of a dual listed corporation that also involves the acquirer obtaining an ownership interest in the acquiree, but that ownership interest on its own (ie excluding the other terms of the contract) does not give the acquirer control of the acquiree. Consequently, such combinations would be

[1] 'Stapled securities' refers to a situation in which a listed legal entity (typically a company) has issued equity instruments that are combined with ('stapled' to) the equity instruments issued by another legal entity (typically a trust). The stapled securities cannot be traded independently and are quoted at a single price. The stapling results in the two (or more) legal entities having equity holders in common. Such transactions are generally tax-driven. They meet the IFRS 3 definition of a business combination because they in substance involve 'the bringing together of separate entities or business into one reporting entity' (a reporting entity is defined in IFRS 3 as one 'for which there are users who rely on the entity's general purpose financial statements for information that will be useful to them for making decisions about the allocation of resources. A reporting entity can be a single entity or a group …').

[2] This includes reverse acquisitions because there is no 'cost' in the traditional sense *given by the acquirer* in exchange for control—it is the 'legal acquirer' (ie the acquiree for accounting purposes) that purchases an ownership interest in the 'legal acquiree' (ie the acquirer for accounting purposes).

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required to be accounted for by applying the purchase method principles in IFRS 3. This means that goodwill would be recognised by the acquirer, but only to the extent that it is attributable to the ownership interest held by the acquirer in the acquiree.

Identifying an acquirer and the interaction between IFRS 3 and IAS 27

A business combination is defined in IFRS 3 as 'the bringing together of separate entities or businesses into one reporting entity'. The Board's view is that as with any 'traditional' business combination, when separate mutual entities are brought together into one reporting entity or when separate entities are brought together solely as a result of contractual arrangements without the obtaining of an ownership interest, the result generally is that one of the combining entities ends up with the ability to direct the financial and operating policies of the other combining entity so as to obtain benefits from its activities. Nevertheless, the Basis for Conclusions on IFRS 3 leaves open the possibility that a business combination (however rarely) might not involve one of the combining entities obtaining control of the other combining entity (or entities).

Some constituents suggested that if a business combination did not involve one of the combining entities obtaining control of the other combining entity (or entities), the entity identified as the acquirer for purposes of applying IFRS 3 would not meet the definition in IAS 27 *Consolidated and Separate Financial Statements* of a 'parent' (ie an entity that has one or more subsidiaries). Therefore, the acquirer would not be required to prepare consolidated financial statements.

The Board was concerned by this suggestion and noted that:

- IFRS 3 defines the acquirer in a business combination as 'the combining entity that obtains control of the other combining entities or businesses'.
- 'control' has the same definition in IFRS 3 as in IAS 27 (ie the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities).
- the intended interaction between IFRS 3 and IAS 27 is that an entity that is identified as the 'acquirer' of another entity in accordance with IFRS 3, is a 'parent' for the purposes of IAS 27. Therefore, it is required to prepare consolidated financial statements that include on a line-by-line basis the assets, liabilities, income and expenses of the subsidiary. In other words, the requirement in IAS 27 for a parent to prepare consolidated financial statements applies to all entities that are, in accordance with IFRS 3, identified as an acquirer of another entity.

Communication with respondents

Given its decision not to proceed with the proposals in the Exposure Draft, the Board instructed the staff to provide each of the respondents to the Exposure Draft with a summary of the Board's redeliberations (as reported in this edition of *IASB Update*).

Business combinations (phase II)

Combinations of mutual entities

The Board considered whether its tentative decisions in the purchase method procedures project should apply to combinations of mutual entities. The Board observed that mutual entities have many important characteristics that are similar to those of other business entities. It also noted that they possess characteristics that distinguish them from other business entities but it concluded that there are no unique circumstances for combinations of mutual entities that would justify a different accounting for those combinations. In particular, the Board tentatively decided:

- to require the purchase method of accounting for combinations of two or more mutual entities.
- that difficulties in identifying the acquirer are not substantively different from those encountered by non-mutuals to be a sufficient reason to justify a different accounting treatment. No additional guidance should be included in the Exposure Draft for identifying the acquirer for combinations of two or more mutual entities.
- to include in the Exposure Draft guidance for measuring the fair value of an acquired mutual entity similar to that being considered by the Canadian Accounting Standards Board and the US Financial Accounting Standards Board.
- to require that in a business combination in which the acquirer exchanges member interests for the member interests of the acquired mutual entity, the fair value of the acquired mutual entity should be presented as a direct addition to a properly labelled capital or equity account (not retained earnings) and that the method of determining the fair value of those interests should be disclosed.
- not to provide as part of the purchase method procedures project detailed guidance for the valuation by mutual entities of acquired loans, deposits, or intangible assets.
- to require mutual entities to disclose the accounting for the member interests transferred.

Fair value hierarchy

The FASB and the IASB decided in this project to adopt additional guidance for measuring fair value in the form of a hierarchy (the *fair value hierarchy*) to ensure consistent application of the fair value measurement requirement to business combinations.

The FASB subsequently amended the fair value hierarchy to reflect decisions it made as part of its Fair Value Measurements project. The FASB plans to refer to that amended hierarchy in its forthcoming exposure draft (ED) on business combinations. The IASB has not considered all of the issues the FASB considered that resulted in the FASB amendments.

Therefore, in the interests of convergence, the Board tentatively decided at its meeting in June 2004 to consider all of the issues that resulted in the changes to the hierarchy made by the FASB. It also tentatively decided that the fair value hierarchy should be exposed as a separate ED. At this meeting the Board reconsidered the decision to expose a separate ED. Instead it decided to consider at a later stage exposing a document that deals generally with fair value measurement issues similar to the FASB's ED on fair value measurement.

The Board also decided to consider at a later meeting whether to include in its forthcoming ED on business combinations parts of the FASB's ED on fair value measurement that are relevant to understanding and applying the fair value hierarchy and are important for a convergent application of the hierarchy by preparers entering into business combinations using IFRSs and US GAAP. Specifically the Board decided:

- to consider whether the definition of fair value should be consistent with the FASB ED's definition and if so whether to provide additional guidance on 'willing', 'knowledgeable' and 'unrelated parties'.
- to consider providing guidance on valuation techniques and market inputs.
- to consider whether the definition of an active market should be consistent with the FASB ED's definition.

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Conceptual framework

At the joint meeting with the FASB in April 2004, the two boards discussed a staff proposal for a joint project to develop a common conceptual framework. The meeting was administrative and no changes were made to either the IASB or FASB technical agendas. The boards agreed with the objective of moving toward a single conceptual framework. They directed the staff to develop a plan for conducting such a project, for discussion at the next joint meeting in October.

In September, the IASB had a preliminary discussion of planning issues relating to the proposed joint project, to be discussed with the FASB in October. The Board did not make any decisions.

Exploration for and evaluation of mineral resources

In July 2004, the Board tentatively agreed with a staff recommendation to eliminate the special cash-generating unit (CGU) for exploration and evaluation assets proposed in ED 6. However, the Board expressed concern that requiring entities to use IAS 36 CGUs could force entities recognising exploration assets to test for impairment at a very low level. It directed the staff to investigate this further. The staff highlighted this concern in the July 2004 issue of *IASB Update*, in the Website project summary and in the *Effect of Redeliberations* document (also on the Website). These materials were sent to the IASB's research project team and other industry representative groups with a request to encourage constituents to respond to the issues raised. The staff received 16 comment letters as a result of this consultation, which are available on the IASB's Website.

The level at which impairment is assessed

The Board tentatively decided to adopt an approach that requires management to allocate exploration and evaluation assets to an appropriate level and test impairment at this level. This approach is similar to that taken for the impairment of goodwill in the 2004 revisions to IAS 36. The Board considers this is the best model available within IFRSs to accomplish this objective. The level might or might not be the same as an area of interest.

Because the proposal would permit CGUs to be aggregated, the Board decided to mirror the goodwill requirements in IAS 36 and require that the level be no higher than a segment, based on either the entity's primary or secondary segment reporting format in accordance with IAS 14 *Segment Reporting*. This requirement is essentially the same as ED 6's requirement that the special CGU should 'be no larger than a segment'.

Other issues

The Board tentatively decided that the results of its redeliberations did not require re-exposure for the following reasons:

- No fundamental changes of principle have been made.
- Changes to ED 6 have been made to matters addressed in the invitation to comment on which constituents' comments were invited. The Board has considered the comments received and the basis for alternatives suggested both by constituents and as a result of its own redeliberations. It is doubtful that re-exposure would yield any new information that has not already been shared with the Board.

Next steps

The Board directed the staff to prepare a ballot draft of IFRS 6. Four Board members indicated an intention to dissent from the IFRS, on the basis of the partial exemption from the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* it provided. One of those Board members also indicated an intention to dissent on the basis of the approach to testing for impairment.

The Board intends to issue IFRS 6 *Exploration for and Evaluation of Mineral Resources* in the fourth quarter of 2004.

Financial instruments: the fair value option

The Board considered an analysis of the 115 comment letters received on the Exposure Draft *Amendments to IAS 39: The Fair Value Option*. In particular, the Board noted that a large majority of respondents did not agree with the proposals in the Exposure Draft, including a majority of all categories of respondents except regulators. The Board began to discuss possible ways in which the Board might proceed in the light of these comments.

The Board noted the very low level of support for the proposals in the Exposure Draft. The Board also noted that reverting to IAS 39 (as revised in March 2004) would not address the concerns of regulators, which were the reason for issuing the Exposure Draft.

The Board tentatively decided to explore a number of possibilities for obtaining additional input on possible courses of action. These include holding a public meeting to which it would invite constituents with opposing views. Such a meeting would explore a range of potential ways forward and their operationality. The aim would be to establish whether there is a solution that would be acceptable to all parties—the Board, constituents and regulators.

Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

A first draft of an exposure draft of amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* had been circulated to the Board. The amendments result from two projects:

(a) the Short-term Convergence project, in which the Board is seeking convergence of the recognition requirements relating to restructuring costs in IAS 37 with those of SFAS 146 *Accounting for Costs Associated with Exit or Disposal Activities*; and

(b) the second phase of the Business Combinations project, in which the Board has amended the definitions of contingent assets and liabilities.

The IAS 37 amendments to restructuring costs require consequential amendments to the termination benefits requirements in IAS 19 *Employee Benefits*.

At this meeting the Board discussed some issues that drafting the ED had identified.

IAS 37

The Board discussed the application of the probability recognition criterion in IAS 37 (paragraph 14(b)). The Board noted that under the *Framework* the criterion is not used to determine whether an entity has a liability. Rather, the criterion is used to determine whether it is probable that settlement of an item that satisfies the definition of a liability will require an outflow of economic resources. The Board noted that it was particularly important to apply the criterion to the unconditional

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obligation (liability) rather than to any conditional obligation (contingent liability) associated with that liability. So, for example, in the case of a guarantee the criterion is applied to the unconditional obligation to stand ready to honour the guarantee for the duration of the contract rather than the conditional obligation to make a payment under the guarantee. Similarly, in the case of a lawsuit, the criterion is applied to the unconditional obligation to stand ready to accept the decision of the court, rather than the conditional obligation to pay damages.

The Board noted that the *Framework* describes the probability recognition criterion in terms of an outflow of economic resources (not just cash flows). This includes the provision of services. Therefore the Board reasoned that, eg in the case of a guarantee, the probability criterion is satisfied because it is certain that the obligation will require an outflow of economic resources (ie the stand ready service). Similarly in the case of a lawsuit the probability criterion is satisfied because it is certain that the entity is standing ready to accept the decision of the courts.

The Board tentatively decided that the clearest way of reinforcing this interpretation of the probability recognition criterion would be to omit the criterion from the amended Standard, on the grounds that it will always be met and is therefore unnecessary. Consequently, an item that satisfies the definition of a provision would be recognised, unless its amount cannot be measured reliably.

The Board also noted some other matters for discussion at a subsequent meeting:

- linking the revised paragraphs dealing with constructive obligations to the Board's tentative decision in its Revenue Recognition project to define a contract as a set of promises that a court will enforce. The Board observed that a constructive obligation is an obligation that would be likely to be enforced by the courts.
- distinguishing contractual obligations from obligations arising from the operation of law.
- clarifying that rights to reimbursements should not be offset against provisions.
- clarifying the subsequent measurement of provisions under IAS 37.
- determining whether the consensus in IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* should be incorporated into the amended IAS 37.
- determining whether the amendments to IAS 37 should be issued as a new IFRS rather as an amendment to the existing Standard.

IAS 19

The Board previously decided that its objective in amending IAS 19 was convergence with the principle of SFAS 146 for one-time termination benefits, but to apply that principle to all termination benefits.

The Board tentatively decided to amend the definition of termination benefits in IAS 19 to clarify that voluntary termination benefits are benefits that are offered in exchange for an employee's decision to accept voluntary termination and are incremental to what an employee would otherwise be entitled. Accordingly, benefits payable introduced in a long-term plan to encourage employees to accept early retirement would not be termination benefits but plan amendments.

The Board discussed the measurement of termination benefits and considered whether all termination benefits in IAS 19 should be measured at fair value. It noted that under SFAS 146 one-time termination benefits are measured at fair value, but under other Standards voluntary termination benefits (ie special termination benefits) are measured at the amount of any lump-sum payments and the present value of any expected future payments. The Board also noted that termination benefits might be provided by an enhancement of an existing benefit plan. The Board questioned whether in such instances it would be appropriate to measure the termination benefits at fair value, given the measurement of the underlying benefit plan in accordance with IAS 19. The Board directed the staff to consider further the most appropriate way of converging with US GAAP on the measurement of termination benefits.

IASB Deliberative Processes

The IASB is undertaking an internal review of its own deliberative procedures. The IASB identified several areas where improvement could enhance public understanding of and confidence in its procedures. The IASB's provisional conclusion and proposals were set out in the consultation paper *Strengthening the IASB's Deliberative Processes*. Particular attention was given to the following matters:

- the accessibility and transparency of the IASB's deliberative process
- the IASB's responsiveness to constituents' comments
- the extent of consultation before releasing proposals and Standards

The IASC Foundation Trustees have stated that their Constitution Committee will review the IASB's conclusions on the deliberative process as part of its broader consideration of possible changes to the Constitution.

The Board received 50 comment letters on the consultation paper. With the exception of five comments on the publication of near-final drafts, there was strong support for the steps proposed.

After considering further actions recommended by some respondents, the Board tentatively decided:

- to continue to make observer notes available on its Website, with paragraph numbers corresponding to those in the Board's papers.
- to make all public meetings available, if possible, by Internet or audio.
- to publish near-final drafts of final documents only.
- to enhance the due process procedures as proposed and to explain its reasons when it decides not to undertake a non-mandatory step of its due process.
- to conduct field tests when appropriate
- to distinguish clearly field tests, field visits and other means of obtaining input from constituents while an IFRS is being developed.
- to vary the length of comment periods, taking account of the complexity of the project and with sensitivity to the problems of translation.
- to clarify the procedure for adding items to its agenda.

Short-term convergence – IAS 12 *Income Taxes*

The staff provided the Board with an update on the status of the short-term convergence project on income taxes. The Board reviewed a summary of the issues identified and discussed so far by the IASB. A copy of the summary was included in the Observer Notes and is available at www.iasb.org. As part of the project update, the staff also informed the Board of recent

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FASB activities related to the short-term convergence project on income taxes.

The staff reported that the FASB and IASB staffs are working to develop a joint paper to present at the joint meeting in October on the practical and cost/benefit considerations of recognising deferred taxes on unremitted earnings of foreign subsidiaries. The paper will include information received from constituents on the complexity of the calculation.

The Board discussed the FASB's agreement to issue an Interpretation to clarify the recognition criteria of SFAS 109 *Accounting for Income Taxes* in respect of the recognition of tax benefits. The primary purpose of the proposed Interpretation is to provide guidance on what threshold or confidence level must be met to determine that a temporary difference exists. Both SFAS 109 and IAS 12 provide guidance on the threshold for recognising a deferred tax asset once a temporary difference has been identified, but do not provide guidance on what constitutes a valid temporary difference. The Board was advised that the proposed Interpretation incorporates some aspects of the IASB's tentative decisions on tax base (see June 2004 *IASB Update*). However, those tentative decisions do not include the necessary level of confidence for determining a tax base and the related add-on issues addressed in the proposed Interpretation. The Board decided that the scope of the short-term convergence project on income taxes should include the issues in the proposed Interpretation of Statement 109.

Short-term convergence: Post-employment benefits

The Board began its redeliberation of the proposals in the exposure draft *Amendments to IAS 19: Actuarial Gains and Losses, Group Plans and Disclosures* in the light of the responses. The Board noted the numerous requests for a comprehensive review of post-employment benefits and confirmed its intention to undertake such a project when staff resources allow.

Recognition of actuarial gains and losses

The Board tentatively decided to proceed with the option as proposed in the ED, ie:

- to permit the recognition of actuarial gains and losses in full in the period in which they occur outside profit or loss in a statement of recognised income and expense.
- to prohibit actuarial gains and losses recognised in a statement of recognised income and expense from being recognised in profit or loss in a subsequent period (recycling).
- to require actuarial gains and losses recognised in a statement of recognised income and expense to be recognised immediately in retained earnings rather than a separate component of equity.
- to require entities adopting the option to treat the effect of the asset ceiling as an actuarial gain or loss.

Disclosure of the cumulative amount recognised in the statement of recognised income and expense will be considered when the disclosures proposed in the ED are reconsidered.

The Board instructed the staff to make it clear in the Basis for Conclusions that its decisions on these issues, in particular the use of a statement of recognised income and expense and the prohibition of recycling are not necessarily an indication of what the Board will decide when it considers issues of reporting comprehensive income more generally. The Board is not prejudging the outcome of those future debates. The Board is simply allowing an accounting treatment currently accepted in a national standard-setter's jurisdiction to continue pending the comprehensive reviews of post-employment benefits and reporting comprehensive income.

Group plans

The ED proposed that, in their separate or individual financial statements, group entities that met specified criteria could treat group plans as multi-employer plans. Group entities that did not meet the criteria should apply defined benefit accounting using a reasonable basis of allocation.

The Board concluded that the proposals in the ED were too complex. The treatment of group plans in the individual or separate financial statements of group entities should not be linked with the treatment of multi-employer plans, because information about the plan as a whole would be available for group plans. The Board decided that group entities should be required to apply defined benefit accounting to group plans if, having measured the plan using assumptions applicable to the plan as a whole, it was possible to make a reasonable allocation of the plan.

The staff was instructed to develop examples of (i) the basis for a reasonable allocation and (ii) situations in which no reasonable basis for allocation could be found.

Share-based Payment

Update on FASB redeliberations

In March 2003, the FASB added to its agenda a project to review existing US guidance on accounting for share-based payment. (More information on the FASB project is available on their Website www.fasb.org.) At that time, the IASB was about to begin redeliberating the proposals in ED 2 *Share-based Payment*. The two boards decided to work together to achieve convergence of their respective standards to the extent possible, given the different stages of their projects.

The IASB issued IFRS 2 *Share-based Payment* in February 2004. In March 2004, the FASB published an Exposure Draft *Share-Based Payment*, which contains proposals that are substantially similar to IFRS 2. The FASB invited comments on its ED by 30 June 2004. In August, the FASB began redeliberating the proposals in the ED, in the light of comments received.

In September, the staff presented a report on the FASB's redeliberations, but did not ask the Board to make any tentative decisions on issues discussed.

The staff reported that, in most cases, the FASB's decisions are consistent with the requirements of IFRS 2. However, there are some differences. The staff also noted that the current FASB redeliberations relate to the first stage of its project on share-based payment, concerning transactions with employees. The FASB has not yet begun reviewing US accounting requirements for transactions with parties other than employees (Under FAS 123 *Stock-Based Compensation* such transactions are recognised in profit or loss.) The staff noted that, at the joint meeting of the IASB and FASB in October 2003, the boards agreed that, when both had a standard on share-based payment, they would consider undertaking a project to eliminate any differences between their respective standards.

Scope of IFRS 2 and IFRS 3

At the request of the IFRIC Agenda Committee, the staff asked the Board to clarify an issue concerning the respective scope of IFRS 2 and IFRS 3 *Business Combinations*.

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IFRS 2 excludes from its scope transactions in which the entity acquires goods as part of the net assets acquired in a business combination to which IFRS 3 applies. [IFRS 2, paragraph 5]

Because certain business combinations are excluded from the scope of IFRS 3, the wording of paragraph 5 of IFRS 2 might lead to the conclusion that those business combinations *are* within the scope of IFRS 2. In the view of the staff and the IFRIC Agenda Committee, this was not the Board's intention.

Therefore, the staff asked the Board to confirm that, by excluding certain business combinations from the scope of IFRS 3, it did not intend that share-based payments related to these business combinations should be within the scope of IFRS 2. The Board confirmed the staff's interpretation of its intention. It noted that its intention was to exclude from the scope of IFRS 2 transactions in which the entity acquires goods as part of the net assets acquired in a business combination, *as defined* in IFRS 3, not business combinations within the scope of IFRS 3. The Board also noted that some of the business combinations are excluded from the scope of IFRS 3 as an interim measure, because the Board is considering issues relating to accounting for those combinations in phase II of its Business Combinations project. (*See also* Business Combinations (phase I) *above.*)

Financial reporting standards for small and medium-sized entities

The Board discussed two broad approaches to the format and content of IASB Standards for SMEs:

(a) IASB Standards for SMEs should primarily be a reorganisation of all of the principles in the IFRSs to make the standards more useful to SMEs. An SME that wishes to assert that its financial statements conform to IASB Standards for SMEs would be required to follow all, or virtually all, of the recognition and measurement principles in all IFRSs. However, because some of those principles are not likely to be relevant for many SMEs, the IASB Standards for SMEs might put the less relevant material in one or more appendices or might omit the material entirely, with a requirement to look to the IFRS if an issue confronting an SME is addressed there. The SME standards would contain appropriate references back to the IFRSs.

(b) IASB Standards for SMEs should be a self-contained and reduced version of IFRSs that includes those recognition and measurement principles of relevance to the majority of SMEs. In some cases, the principles in the IASB Standards for SMEs might differ from those in IFRSs. There would not be references back to full IFRSs, or mandatory or optional 'fallbacks'.

Both approaches would start with extracting the principles from IFRSs. They would differ in the extent to which the recognition and measurement requirements of IFRSs would apply to SMEs. They would also differ in degree of detail.

The staff have prepared and presented to the Board 13 preliminary SME versions of IFRSs. Development of those standards has followed the first approach above more closely than the second.

At this meeting, the staff presented to the Board an approach by which the IASB Standards for SMEs would include only broad principles plus any critical guidance, with a general reference back to the full IFRSs. The IASC Foundation's Education Department would publish, concurrently with the relatively brief IASB Standards for SMEs, guidance that is expressly tailored for SMEs, including the relevant material from the IFRS that has been omitted in the SME version of the standard.

Staff presented two examples of this approach to the Board based on IAS 29 and IAS 41.

The Board concluded that any decision about these approaches was premature and should await analysis of the comments on the Discussion Paper *Preliminary Views on Accounting Standards for Small and Medium-sized Entities*. The staff was asked to prepare a preliminary analysis for consideration at the Board's meeting in October 2004.

Board discussion focused on the overall approaches to format and content of IASB Standards for SMEs described above. Preliminary or revised preliminary drafts of thirteen IASB Standards for SMEs, prepared by the staff and distributed as Observer Notes, were not discussed.

The Board discussed how to deal with suggestions for changes to full IFRSs that arise as part of the Board's process for considering the SME versions of the IFRSs. The Board asked the staff to maintain a list of these for future consideration as possible amendments to IFRSs.

Public education sessions

Public education sessions are used to provide background and education on difficult issues, to help the staff identify potential points of confusion or ideas for solutions. The sessions consider issues to be discussed in subsequent months' meetings. In September, the Board held public education sessions on the following topics:

- Income taxes: allocations to shareholders' equity ('backwards tracing')
- Insurance
- Service concession arrangements (see *IFRIC Update* September 2004 for background).

No decisions were made at these sessions.

Meeting dates: 2004

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

18—20 October, Norwalk, Connecticut, USA

15—19 November†

14—17 December

† Includes a meeting with the Standards Advisory Council

‡ Includes meetings with partner standard-setters

§ Includes meetings with other national standard-setters

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