

The International Accounting Standards Board met in London on 22 – 23 June, when it discussed:

- Emission rights
- Convertible bonds issued in a foreign currency
- Conceptual Framework
- Performance Reporting
- Revenue recognition
- Short-term convergence: income taxes
- Short-term convergence: segment reporting
- Management commentary
- Proposed amendments to IFRS 6 and IFRS 1
- IAS 21 - Net investment in a foreign operation
- IASB technical corrections policy

## Emission rights

The Board considered alternatives the IFRIC had discussed in its previous three meetings for amending the Standards underlying accounting for emission rights. In particular, it noted that the IFRIC had developed a possible amendment to IAS 38 *Intangible Assets* that would permit allowances to be measured at fair value with changes in value recognised in profit or loss. It also noted that the staff at the EFRAG had developed a proposal that would permit allowances to be designated as a hedging instrument. (Details of these alternatives can be found in the observer note for the meeting on the IASB's Website [www.iasb.org](http://www.iasb.org))

The Board acknowledged that an unsatisfactory consequence of the interaction of IAS 38 and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* was to create:

- (a) a measurement mismatch between the assets and liabilities recognised in accordance with IFRIC 3, and
- (b) a mismatch in the location in which the gains and losses on those assets are reported.

The Board noted that some constituents believe that there is also a timing mismatch that should be addressed. This mismatch arises because allowances are recognised when they are obtained, which typically is at the start of the year,

whereas the emissions liability is recognised over the year as it is incurred. Some believe that the changes in the carrying amount of allowances that the entity intends to use to settle liabilities arising from future emissions should be recognised in profit or loss only when those liabilities are recognised.

The Board noted that it has an active project to amend IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, another Standard that is applicable to emission rights granted by governments. An amendment to IAS 20 that delayed recognition of a gain associated with obtaining emission allowances could eliminate the perceived timing mismatch between allowances and the liability. The Board made no decision on this point. However, the Board noted that making an amendment to IAS 38 (or IAS 39 *Financial Instruments: Recognition and Measurement*) in the short term to address the measurement mismatch might have to be reconsidered again when IAS 20 is amended. The Board acknowledged the effect of changes to IFRSs on constituents, including preparers and users, and concluded that a series of changes in accounting for emission rights would not be helpful. Thus, the Board decided that it would be inappropriate to amend Standards to address the measurement and reporting mismatches, and to explore whether there is a recognition mismatch to be addressed, before it had considered the effects of the revised IAS 20 on the accounting for allowances received from government.

### Withdrawal of IFRIC 3

The Board observed that in developing IFRIC 3, the IFRIC had appropriately addressed how existing Standards apply to emission rights. The Board also reaffirmed its view that IFRIC 3 is an appropriate interpretation of existing IFRSs. However, the Board was informed that although the EU Emissions Trading Scheme started in 2005, not all allowances have yet been allocated. Furthermore, the markets for allowances that are necessary for the scheme's proper functioning, although developing rapidly, are at present thin. Accordingly, at this early stage of the scheme's development, the Board observed that it

was questionable whether there was as urgent a need for an Interpretation as originally concluded by the IFRIC in 2004. In the light of the reduced urgency for an Interpretation, the Board decided to withdraw IFRIC 3, with immediate effect. This will enable it to address the underlying accounting in a more comprehensive way than originally envisaged by the IFRIC. The Board also decided that because developing a co-ordinated approach will require the amendment of one or more standards, it would be more appropriate and efficient for the Board to reconsider the accounting for cap and trade emission right schemes itself, rather than ask the IFRIC to continue its work on developing amendments to the relevant Standards.

## Convertible bonds issued in a foreign currency

The Board discussed the issue of classification under IAS 32 *Financial Instruments: Disclosure and Presentation* of the written option in a convertible bond denominated in a foreign currency (ie currency other than the functional currency of the entity issuing the bond). The Board decided to explore possible limited scope amendments to IAS 32 so that, for classification purposes only, contracts are classified as equity if they will be settled by an entity by delivering a fixed number of its own equity instruments for a fixed amount of cash or another financial asset denominated in a foreign currency.

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**All decisions reported in IASB Update are tentative unless otherwise indicated.**

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## Conceptual Framework

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The Board continued its deliberations on the joint IASB/FASB conceptual framework project. The Board discussed issues relating to qualitative characteristics of accounting information, including the existing characteristics of comparability and understandability, and potential new characteristics. The Board reached the following conclusions:

- **Comparability** is an important characteristic of decision-useful financial information and should be included in the converged conceptual framework. Comparability—which enables users to identify similarities in and differences between economic phenomena—should be distinguished from consistency—the consistent use of accounting methods. Concerns about comparability or consistency should not preclude reporting information that is of greater relevance, or that more faithfully represents the economic phenomena it purports to represent. If such concerns arise, disclosures can help to compensate for lessened comparability or consistency.
- **Understandability** also is an essential characteristic of decision-useful financial information and should be included in the converged conceptual framework. Information is made more understandable by aggregating, classifying, characterising, and presenting it clearly and concisely. Whether reported information is sufficiently understandable depends on who is using it. The information in general-purpose external financial reports should be understandable to financial statement users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. Relevant information should not be excluded because it is too complex or difficult for some users to understand.
- **Materiality** relates not only to relevance, but also to faithful representation. Materiality should be included in the converged framework as a screen or filter to determine whether information is sufficiently significant to influence the decisions of users in the context of the entity, rather than as a qualitative characteristic of decision useful financial information.
- **Transparency**, often cited recently as a desirable characteristic of financial information, seems to be difficult to define. In current usage, it appears to encompass some of the qualitative characteristics already included in the framework. Because it would be redundant, transparency should not be added to the converged framework as a separate qualitative characteristic of decision useful financial information.
- Other possible characteristics considered, including credibility, high quality and internal consistency, do not describe attributes of decision useful financial information that are distinct from other qualitative characteristics. Thus, they should not be added as separate qualitative characteristics in the converged framework.
- The converged framework should include information about the types of costs that should be considered in deciding what financial information to provide, as well as criteria to help standard setters decide how to take particular types of costs into account.

- The converged framework should include presumptions not only about the capabilities of financial statement users but also about the capabilities of financial statement preparers and auditors.

The FASB separately discussed the same issues and reached similar conclusions. The boards plan to discuss how the qualitative characteristics relate to one another at meetings in July.

## Performance Reporting

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The staff updated the Board on the discussions at the second meeting of the Joint International Group (JIG) on Performance Reporting held in New York on 14 June 2005. The discussions focused on three topics:

- (a) Presentations by JIG members: What does net income mean?
- (b) Update on Segment A of the Performance Reporting project
- (c) Categorisation in a statement of earnings and comprehensive income

The general themes from the discussions of the meaning of net income and categorisation in a statement of earnings and comprehensive income included the following:

- (a) Categorisation within a statement of earnings and comprehensive income is critical and useful, but determining the appropriate model is difficult and challenging.
- (b) Various categorisation models have their own benefits and limitations eg operating versus non-operating; realised versus unrealised.
- (c) A separate category for financing would be desirable, but defining the category is difficult.
- (d) An operating category would be desirable, but further disaggregation or categorisation is necessary to help separate items in the operating category.

JIG members expressed their views on the boards' tentative decisions in Segment A of the Performance Reporting project. Several of the preparers expressed concern about the proposed single statement of earnings and comprehensive income and the absence of net income as the bottom line, even though it would be a required subtotal. Other JIG members, including users, argued that both net income and comprehensive income are important measures. Requiring a single statement of earnings and comprehensive income with both amounts required to be presented in it was considered to be a reasonable compromise.

In response to the reactions on Segment A, the Board discussed its decision to publish an Exposure Draft, rather than a Discussion Paper. It also discussed its decision to require a single statement of earnings and comprehensive income, with net income as a required subtotal. The Board did not make any decisions at this meeting. The staff will continue drafting the Exposure Draft for Segment A of the project based on the decisions previously made jointly with the FASB.

## Revenue recognition

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The Board reviewed the direction of the project on revenue recognition, which is being jointly conducted with the US FASB. The review followed a similar review by the FASB in May. The reviews were prompted by concerns that both

Boards were finding it difficult to achieve consensus on some aspects of the conceptual model that had been developed in the project.

The Board confirmed its desire to continue the joint project, with the same goals and scope as before, ie to develop a conceptual model for revenue recognition and a general standard derived from that model. It also reaffirmed its past decision that the general standard should require revenue to be recognised on the basis of changes in assets and liabilities, without consideration of additional recognition criteria, such as earnings or realisation.

However, the Board decided to continue the project pursuing an alternative approach to measuring the liabilities ('performance obligations') that an entity incurs in a contract to provide goods or services to a customer. In its previous deliberations, the Board had developed an approach in which performance obligations would be measured at their 'legal lay-off amount', ie the amount that the entity would have to pay to transfer the obligation to another entity in a business-to-business market. The alternative approach would measure performance obligations at the amount that a customer would pay the entity for fulfilling them. In general, this amount would be measured by allocating the total consideration received or receivable from a customer among the various performance obligations within the contract. Revenue would be recognised only as the obligations were extinguished by delivery of goods or performance of services.

The Board reiterated its view that the legal lay-off amount was the most relevant measure of a performance obligation. However, it acknowledged concerns about the practical problems and measurement uncertainties that might arise in applying this approach. The Board noted that the alternative approach could be modified to allow performance obligations to be measured at their legal lay-off amount if an active market existed for those obligations. It decided to consider this possibility further as it developed the alternative approach.

The FASB has also decided that it wishes to continue the project and, like the IASB, wishes to explore the alternative approach to measuring performance obligations discussed above. The two boards will continue working on revenue recognition as a joint project.

## Short-term convergence: income taxes

The Board considered papers on two issues:

- Disclosures
- Uncertain tax positions

### Disclosures

The Board considered the differences between the disclosure requirements of IAS 12 and SFAS 109 and noted the FASB decisions relating to those differences, as set out below. The Board made the following decisions.

- Adjustments recognised in the period for current tax of prior periods are given as an example of a significant component of income expense that should be disclosed. SFAS 109 does not include this example. The FASB decided to add the example to SFAS 109. The IASB decided to keep the example in IAS 12.
- Examples of significant components of income expense given in SFAS 109 but not IAS 12 are:

- (a) adjustment for change in tax status of an entity
- (b) tax benefits allocated directly to contributed capital or to goodwill

The FASB decided to keep the examples in SFAS 109. The IASB decided to add the examples to IAS 12.

- Contingencies relating to tax balances. The FASB decided not to require further disclosures beyond those required under SFAS 5. The IASB decided to discuss the disclosures in IAS 12 after considering the issue of uncertain tax positions.
- The effect of changes in tax rates or laws substantively enacted after the balance sheet date is required to be disclosed under IAS 12, but not SFAS 109. The FASB decided not to add this disclosure requirement to SFAS 109. The IASB noted that the disclosure was required by IAS 10 *Events after the Balance Sheet Date* and concluded it should be deleted from IAS 12.
- Intercompany transfers of inventory. The FASB decided to add to SFAS 109 requirements for disclosure of:
  - (a) the component of deferred tax assets and liabilities that represents the effect of an intercompany transfer of an asset between taxing jurisdictions with different effective tax rates.
  - (b) any such effect recognised as part of income tax expense (benefit) in the income statement for interim or annual periods. This could apply to all transfers or be limited to transfers whose timing or terms are not customary for the consolidated entity.
  - (c) tax effects of any modifications, including unwinding (reversal), of terms of such transfers.

The IASB decided to add the same disclosures.

- IAS 12, but not SFAS 109, requires disclosure of the amount of a deferred tax asset and the nature of the evidence supporting its recognition when:
  - (a) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and
  - (b) the entity has suffered a loss in either the current or the preceding period in the tax jurisdiction to which the deferred tax asset relates.

The FASB decided not to add this disclosure to SFAS 109. The IASB decided to delete the requirement from IAS 12.

- SFAS 109, but not IAS 12, requires public entities not subject to income taxes because their income is taxed directly to their owners to disclose that fact and the net difference between tax bases and carrying amounts. The FASB decided to keep this disclosure requirement in SFAS 109. The IASB decided to add the requirement to IAS 12, and to make it applicable to all entities.
- IAS 12 and SFAS 109 both require a reconciliation between tax expense and pre-tax accounting profit. However, IAS 12 permits an entity to aggregate separate reconciliations prepared using the domestic rate in each individual jurisdiction, whereas SFAS 109 requires the use of the domestic federal statutory tax rates. The FASB decided to retain the requirement in SFAS 109 to use the domestic federal statutory rate. The IASB decided to amend IAS 12 to require the use of the statutory rate applicable to the parent company.

- Both IAS 12 and SFAS 109 require disclosure of the expiry dates of operating losses and tax credit carryforwards. However, IAS 12 also requires an entity to disclose the expiry date of deductible temporary differences whereas SFAS 109 does not. The FASB decided not to add the requirement relating to deductible temporary differences. The IASB noted a possible example of a deductible temporary difference that expires. The IASB instructed the staff to develop an analysis of the tax base in the example to discover whether such an analysis would resolve the matter. Pending consideration of that analysis, the IASB decided to keep the requirement relating to deductible temporary differences.

- SFAS 109, but not IAS 12, requires an entity that is a member of a group that files a consolidated tax return to disclose in its separately issued financial statements:

- (a) the aggregate amount of current and deferred tax expense for each statement of earnings presented and the amount of any tax-related balances due to or from affiliates as of the date of each statement of financial position presented and
- (b) the principal provisions of the method by which the consolidated amount of current and deferred tax expense is allocated to members of the group and the nature and effect of any changes in that method (and in determining related balances to or from affiliates) during the years for which the disclosures in (a) above are presented.

The FASB decided to keep the disclosures. The IASB had previously decided to converge with the FASB requirements relating to the allocation of tax to members of a group that files a consolidated tax return. Therefore, the IASB decided to add the disclosure requirements to IAS 12.

- IAS 12 contains disclosure requirements regarding the potential income tax consequences of the payment of dividends. In summary, an entity is required to disclose, if practicable, the nature and the amount of income tax consequences that would result from the payment of dividends to shareholders when income is taxed at different rates depending on whether that income is distributed to shareholders. The FASB agreed to add these disclosures to SFAS 109. The IASB decided to keep the disclosures in IAS 12.

- IAS 12, but not SFAS 109, requires disclosure of the amount of income tax consequences of dividends to shareholders of the entity that were proposed or declared before the financial statements were authorised for issue, but are not recognised as a liability in the financial statements. There is no requirement under US GAAP to disclose dividends that were proposed or declared after the balance sheet date. The FASB decided to require disclosure of the income tax consequences if such dividends are disclosed. The IASB decided to keep the disclosure requirement in IAS 12.

- IAS 12 and SFAS 109 have similar requirements relating to foreign unremitted earnings; both require disclosure of the aggregate amount of temporary differences associated with the foreign unremitted earnings that qualify for the recognition exception. However:

- (a) SFAS 109, but not IAS 12, requires disclosure of the types of events that would cause temporary differences that have not been recognised to become taxable.

- (b) IAS 12 encourages (if practicable) disclosure of the unrecognised deferred tax liability, whereas SFAS 109 *requires* disclosure of that liability (if practicable).

- (c) If disclosure of the unrecognised deferred tax liability is not practicable, SFAS 109, but not IAS 12, requires a statement that determination is not practicable.

The FASB decided to keep these disclosures. The IASB noted that, the definition of impracticable in IFRSs creates a higher hurdle than the US GAAP definition of practicable. It is therefore more likely that these disclosures would be required under the IFRS definition. The IASB did not wish to impose a greater disclosure burden on IFRS preparers than on US GAAP preparers and decided not to add these disclosures.

The IASB also considered possible disclosures relating to unremitted foreign earnings beyond those in either IAS 12 or SFAS 109. The FASB had decided not to require additional disclosures. The IASB also decided not to require additional disclosures but to ask a question in the Exposure Draft requesting specific suggestions for useful incremental disclosures.

### Uncertain tax positions

The IASB considered a draft FASB FSP on uncertain tax positions. The IASB expressed concern that the proposals in the draft FSP were inconsistent with the IASB thinking behind the forthcoming proposed amendments to IAS 37, particularly in relation to the use of a probability-based recognition threshold and the use of a single point of 'best estimate' for measurement. The IASB noted that the proposed amendments to IAS 37 could not be applied directly to uncertain tax positions because the methodology in IAS 12 (and SFAS 109) uses a measurement basis different from the risk-adjusted, expected value, current interest rate measurement basis in IAS 37. Nonetheless, the IASB instructed the staff to analyse the issue of uncertain tax positions in an IAS 12/IFRS context, without reference to US GAAP on contingencies.

### Short-term convergence: segment reporting

At its meeting in January, the Board asked the staff to consider the guidance issued or proposed by the FASB and the Canadian Accounting Standards Board (AcSB) on their standards on segment reporting. The guidance in both jurisdictions relates to the application of the criteria for aggregating segments. However, the FASB has recently decided not to issue the proposed FASB Staff Position (FSP) on how to determine whether two or more operating segments have 'similar economic characteristics' for the purpose of applying paragraph 17 of SFAS 131 *Disclosures about Segments of an Enterprise and Related Information*. At this meeting, the Board decided not to include the Canadian guidance (EIC-115) in the proposed IFRS on segment reporting. In addition the Board asked the staff to include questions in the invitation to comment on the Exposure Draft asking whether the proposed IFRS should depart from the management approach in SFAS 131 by setting requirements for:

- (a) the measurement of specified items; and/or
- (b) the disclosure of specified amounts that might otherwise not be given.

The questions should ask about the cost and benefits of any such requirements.

## Management commentary

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Representatives of the national standard setters participating in the Management Commentary (MC) research project presented a revised draft of their preliminary views discussion paper. The Board asked the project team to consider:

- whether it is appropriate to relate qualitative characteristics for MC to the *Framework*.
- adding suggestions for determining whether information is better presented in MC or in the notes to the financial statements.
- how the illustrative examples are presented.
- separating the objective of MC into components, so that the information requirements can be related to each objective.

The Board decided to publish the discussion paper, once the project team has revised the draft and the Board has reviewed the questions asked of commentators. The discussion paper will have a six months comment period.

## Proposed amendments to IFRS 6 and IFRS 1

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In April 2005 the Board published an Exposure Draft of Proposed Amendments to IFRS 6 *Exploration for and Evaluation of Mineral Resources* and IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The comment period of 30 days ended on 3 June 2005.

The staff presented an analysis of the comment letters received, which showed broad support for the proposed amendments. The Board decided to issue the proposed amendments without altering the wording proposed in the Exposure Draft.

## IAS 21 - Net investment in a foreign operation

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The Board considered an issue related to paragraph 32 of IAS 21 *The Effects of Changes in Foreign Exchange Rates*. For consolidated financial statements, paragraph 32 of IAS 21 requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised in a separate component of equity until disposal of the foreign operation. Paragraph 15 of IAS 21 states that 'a monetary item that is receivable from or payable to a foreign operation...for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation'. Paragraph 33 of IAS 21 restricts the application of the requirement in paragraph 32 to monetary items that are denominated in the functional currency of the reporting entity or the foreign operation.

The issue relating to paragraph 32 of IAS 21 was twofold:

- (a) Did the Board intend to restrict the application of the requirement to monetary items denominated in the functional currency of either the reporting entity or the foreign operation?
- (b) Did the Board intend to restrict the application of the requirement to monetary items transacted between the reporting entity and the foreign operation, or would it also apply to a monetary item transacted between another member of the consolidated group and the foreign operation?

The Board concluded that paragraph 32 of IAS 21 should treat the monetary item in the same way as an equity investment in the foreign operation. This is because the nature of the monetary item is similar to an equity investment, ie settlement of the monetary item is neither planned nor likely to occur in the foreseeable future. Therefore, the Board decided that exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation should be initially recognised in equity in the consolidated financial statements irrespective of the currency of the monetary item and irrespective of whether the reporting entity or its subsidiary enters into the transaction with the foreign operation. An investment by an associate in a member of the consolidated group cannot be part of the reporting entity's net investment in a foreign operation because the reporting entity does not control the associate's investment.

The Board decided to amend IAS 21 as follows:

- (a) The last two sentences of paragraph 33 would be deleted and replaced with wording that clarifies that a monetary item denominated in a third currency (a currency that is the functional currency of neither the reporting entity nor the foreign operation) may form part of the reporting entity's net investment in a foreign operation, provided that the criteria in paragraph 15 of IAS 21 are met.
- (b) Paragraph 15 would be amended to clarify that the monetary item may be transacted between the foreign operation and any member of the consolidated group.

## IASB technical corrections policy

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The Board discussed a proposed IASB technical corrections policy. The draft policy was developed in order to facilitate making technical corrections to Standards on a timely basis. At present, the Board has no means of making amendments to Standards, other than as part of a larger project, or by issuing small single issue exposure drafts.

A technical correction would address issues when it is clear that the words in a Standard are not properly conveying the Board's intentions even when considered with the Basis for Conclusions and any related guidance.

The Board decided that an identified technical correction should be resolved as soon as possible. Therefore, when a technical correction is identified, the staff would present the issue to the Board for consideration. If the Board decided to amend a Standard, the proposed amendment would be published for comment on the IASB Website with notice in *IASB Update*. Generally, a 30-day comment period would apply. Technical corrections would be titled as such eg Technical Correction 1 (TC1), Technical Correction 2 (TC2) etc, ensuring that they are distinguishable from amendments to Standards.

The Board discussed how issues would be filtered either as technical corrections or as those to be considered for interpretation by the IFRIC. The staff will work further on developing the policy in this respect. Once it is finalised, the Board plans to publish the technical corrections policy on the IASB Website.

### **Meeting dates: 2005**

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

18—22 July

19—23 September

17—21 October

24—25 October (joint with FASB) Norwalk, Connecticut, USA

10 and 11<sup>†</sup>; 14—18 November

12—16 December

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

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