BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

January 2007

IASB Update *is published as a convenience for the Board's constituents. All conclusions reported are tentative and may be changed or modified at future Board meetings.*

Decisions become final only after completion of a formal ballot to issue a Standard or Interpretation or to publish an Exposure Draft.

The International Accounting Standards Board met in London on 23 – 25 January, when it discussed:

- Business Combinations II
- Financial instruments
- Financial instruments puttable at fair value and obligations arising on liquidation
- Liabilities and Equity
- IFRS 2 *Share-based Payment*
- Insurance
- Financial statement presentation
- Accounting standards for small and medium-sized entities
- IAS 24 *Related Party Disclosures*
- IAS 37 redeliberations
- Fair value measurements
- Intangible assets
- Short-term convergence: income taxes
- Update on IFRIC activities
- Management commentary

Business Combinations II

The Board continued its redeliberations on the measurement of non-controlling interests (NCI) and goodwill. The Board also discussed the accounting in a business combination for:

- items currently described as contingent assets and contingent liabilities in IFRS 3 *Business Combinations* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*,
- employee benefit plans,
- valuation allowances and
- income tax assets and liabilities.

Non-controlling interests and goodwill

The Board discussed the effects of its tentative decision not to require fair value measurement of NCI on other aspects of the business combinations project and whether entities should be prohibited from measuring NCI at fair value. The Board tentatively decided that, in accordance with the control model, once control has been achieved any changes in ownership interests (such as subsequent acquisitions or dispositions) between controlling and non-controlling interests are transfers between owners and there should be no adjustment to goodwill.

The Board asked the staff to analyse further the basis for permitting or requiring NCI to be measured at fair value in some circumstances.

Assets and liabilities currently described as 'contingent'

The Board discussed the accounting for those items described as contingent assets and contingent liabilities in IFRS 3 and IAS 37. Taking into consideration the existence and timing of the project to amend IAS 37, the Board tentatively decided to retain the existing IFRS 3 guidance with the following improvements that have been affirmed by the Board in the IAS 37 redeliberations:

- the business combinations standard should clarify that only those items that satisfy the definition of an asset or liability should be recognised in a business combination. The terms contingent asset and contingent liability should not be used in the business combinations standard, in order to make it clear that possible assets and possible liabilities should not be recognised; and
- the probability recognition criterion for liabilities should be removed from the business combinations standard. The probability recognition criterion does not apply to contingent liabilities in the existing IFRS 3.

The guidance in the business combinations standard will be reviewed when the Board considers consequential amendments in the IAS 37 project.

Employee benefit plans

In May 2006 the Board tentatively affirmed the Exposure Draft proposal that post-employment benefit liabilities assumed in a business combination should not be measured at fair value. At this meeting the Board tentatively decided to extend this measurement exception to all assets and liabilities within the scope of IAS 19 *Employee Benefits*. Therefore, all assets acquired and liabilities assumed in a business combination that are related to short-term employee benefits, post-employment benefits, other long-term employee benefits and termination benefits within the scope of IAS 19 would be measured in accordance with IAS 19.

Valuation allowances

The Board tentatively affirmed the proposal in the Exposure Draft that receivables acquired in a business combination should be measured at their acquisition date fair values. As a consequence, the acquirer would not recognise a separate valuation allowance for uncollectible amounts at the acquisition date because any uncertainty about collections and future cash flows is included in the fair value measure.

However, the Board acknowledged that information on the uncollectible amounts can be important to users of financial statements. Therefore, the Board asked the staff to conduct further research on the presentation and disclosure of the historical performance of receivables acquired in a business combination.

The Board also tentatively decided that the business combinations standard should not specify the unit of measurement for the initial measurement of receivables acquired in a business combination. **(continued)**

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Business Combinations II (continued)

Income tax assets and liabilities

The Board tentatively affirmed the proposal in the Exposure Draft that income tax assets acquired and liabilities assumed in a business combination should be measured in accordance with the guidance in IAS 12 *Income Taxes* rather than at fair value.

In addition, the acquirer should recognise separately from a business combination any changes in the acquirer's deferred tax assets that result from the business combination. Such changes should be recognised in post-combination profit or loss, or in equity as specified in IAS 12.

The Board also tentatively decided to remove the rebuttable presumption in the Exposure Draft that changes to the acquired deferred tax benefits within a year of the business combination should be reflected in goodwill. The Board also tentatively decided that adjustments to the acquired deferred tax benefits would be recognised within the normal measurement period. Therefore, adjustments to the acquired deferred tax benefits recognised within the measurement period that relate to facts and circumstances that existed at the acquisition date should be recognised as an adjustment to goodwill. After the normal measurement period changes in acquired deferred tax benefits should be recognised in income.

Because the Board is developing proposals for the treatment of tax uncertainties in the short-term convergence project on income taxes, the Board decided that, pending those proposals, no changes should be made to IAS 12 relating to tax uncertainties.

The Board also tentatively decided to retain the requirement in IAS 12 to recognise deferred tax assets and liabilities for taxable and deductible temporary differences related to identifiable indefinite-lived intangible assets.

Financial instruments

Due process document

At their joint meeting in April 2006, the IASB and the Financial Accounting Standards Board agreed to a goal of publishing a due process document on financial instruments (as envisaged in their Memorandum of Understanding) by January 2008. The boards agreed that this document would, as far as possible, include the preliminary views of each board.

At this meeting the Board discussed how debtors should measure guaranteed liabilities. The Board tentatively decided that a third-party contractual guarantee does not affect the measurement of a liability by a debtor if the guarantee does not affect the future obligations of the debtor. The Board also tentatively decided that a liability should include any measurement effect arising from the regulatory environment within which the debtor operates, for example statutory deposit insurance.

The Board discussed whether any exception from normal accounting principles in the form of hedge accounting should be permitted. This discussion was based on the Board's prior tentative decision that all items within the scope of the document should be measured at fair value with changes in fair value recognised in profit or loss. The Board tentatively decided that no exceptions (hedge accounting) would be permitted for recognised assets, liabilities and firm commitments within the scope of the document or for any forecast transaction regardless of whether the resulting item would be within the scope. In addition, the Board tentatively decided that the document should include a discussion about whether some form of hedge accounting would be justified for hedged assets, liabilities and firm commitments outside the scope of the document. The Board also tentatively decided that the document will discuss issues arising from foreign exchange risks embedded in items outside the scope of the document.

Board members again observed that the document should discuss other possible approaches to financial instruments, and that it will invite comments on both the alternative approaches and the Board's preliminary views.

Financial instruments puttable at fair value and obligations arising on liquidation

The Board published its Exposure Draft *Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation* on 22 June 2006. The comment period ended on 23 October 2006. Eighty-seven comment letters were received.

The staff presented an analysis of the comment letters to the Board. No decisions were made. The next steps will be a detailed analysis by the staff of the scope of any possible amendment.

Liabilities and Equity

Liabilities and Equity is a modified joint project on which the FASB has the lead during the research stage. This was the first of a series of meetings at which the staff will present the results of that research. The aim is to publish a discussion paper on this topic later in 2007.

The Board discussed the process it will follow to enable it to issue a discussion paper on liabilities and equity. In addition, the Board discussed the project's interaction with the Conceptual Framework project.

The Board also discussed IAS 32 *Financial Instruments: Presentation* implementation issues, as well as the views of interested parties on what 'equity' should be. No decisions were made.

IFRS 2 *Share-based Payment*

The Board continued its deliberations on the proposed Amendments to IFRS 2 *Share-based Payment—Vesting Conditions and Cancellations*. The Board tentatively decided to change the wording of the proposed Amendment to clarify the following issues, in the light of comments received on the review of the pre-ballot draft:

- the accounting treatment of the liability component on cancellation of a share-based payment arrangement
- the definition of vesting conditions
- that performance conditions impute an explicit or implicit employee service requirement.

In addition, the Board asked the staff to include a flowchart in the Implementation Guidance to help in identifying service conditions, performance conditions and non-vesting conditions. The Board also emphasised the importance of clarifying that performance conditions impute service requirements, and decided that this should be dealt with in the Standard, rather than the Basis for Conclusions.

The Board also asked the staff to determine whether the revised proposed changes would create divergence from SFAS 123. If any significant issues arise the Board will discuss the issues at a future Board meeting.

Insurance

The Board continued its discussion of participating contracts. The Board tentatively decided that policyholder participation creates a liability if the insurer has a legal or constructive obligation to pay policyholder dividends. The discussion paper will discuss whether existing guidance on constructive obligations is sufficient and appropriate for participating contracts. The main existing sources of guidance are IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, revisions to IAS 37 proposed in an exposure draft of June 2005, the IASB's *Framework for the Preparation and Presentation of Financial Statements* and, for US GAAP, the FASB's Statement of Financial Accounting Concepts No. 6 *Elements of Financial Statements*.

The Board also continued its discussion of universal life contracts. Universal life contracts give the insurer considerable freedom to vary the rate at which it credits interest to policyholder accounts. The Board tentatively decided that each cash flow scenario used in measuring a universal life contract should include interest credited at the rate that the insurer estimates will apply in that scenario, rather than the contractually required minimum.

The Board has tentatively decided to use a guaranteed insurability test to determine whether the measurement of an insurance liability includes future premiums. Universal life contracts give the policyholder considerable freedom to vary premiums. The Board noted that after the publication of the discussion paper the staff will research further how the guaranteed insurability test would apply to these contracts.

Next steps

In February, the Board will discuss issues identified in individual Board members' review of a draft discussion paper. The plan is to publish the discussion paper in March.

Financial statement presentation

The Board discussed the definition of discontinued operations; disaggregation by function and nature on the statement of comprehensive income; applying the working format to a 'hybrid' entity; and the statement of changes in equity and equity-related issues.

Discontinued operations

The Board tentatively decided that a disposal of a component of an entity should be reported as a discontinued operation only if that component is an operating segment, as defined in IFRS 8 *Operating Segments*. The Board also tentatively decided that, in addition to reporting discontinued operations on the face of the financial statements, an entity should be required to disclose information about the disposal of a component of an entity (as defined in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*), irrespective of whether that disposal is reported as a discontinued operation on the face of the financial statements. The Board asked the staff to consider what information might be required including the following:

(a) the major classes of revenues and expenses, including impairments, interest, depreciation and amortisation expense, and minority interest

(b) the major classes of cash flows (operating, investing, and financing)

(c) the major classes of assets and liabilities

(d) the nature of the disposal activities and the use of the proceeds from the disposal activities.

The Board tentatively decided that the information to be disclosed in the notes would be for all periods presented.

Disaggregation

The Board tentatively decided that an entity should be required to present information on the face of the statement of comprehensive income based on its primary activities (functions). In addition, an entity should present information about the significant costs (by their nature) related to each of those functions either on the face of the statement of comprehensive income or in the notes. The Board also tentatively decided an entity could present information on the face of the statement of comprehensive income based on the nature of its expenses when presentation of information on a functional basis is not relevant (for example, an entity that provides mainly services).

Hybrid entities

The Board discussed to what extent the initial discussion document should address issues associated with application of the working format and related classification guidance by an entity that has both financial and non-financial operations. The Board noted that similar issues would apply to a non-financial entity that includes significantly different businesses, such as both retail and manufacturing. The Board tentatively decided that the initial discussion document should provide its preliminary view on the high level question of how an entity that consists of significantly different businesses should apply the classification criteria.

Statement of changes in equity and other equity-related issues

The Board decided that the statement of changes in equity should include details of the change between the beginning and ending balance of each component of equity, other than accumulated other comprehensive income. Accumulated other comprehensive income would be presented as a single line on the face of the statement of changes in equity. The details for each other comprehensive income item would be presented in the notes. In addition, the Board tentatively decided that proceeds from a single capital transaction should be presented in only one caption on the statement of changes in equity. The Board expressed an interest in including information in the statement of changes in equity to reflect the effect of transactions between ordinary shareholders and other classes of equity holders, ie the transfer of wealth between claimants. It asked the staff to explore that issue for discussion at a future meeting.

The Board tentatively decided that the statement of comprehensive income should not be expanded to include all changes in net assets (ie it would continue to exclude changes related to transactions with owners). The Board also tentatively decided to modify the proposed working format to present equity items and equity transactions in a separate section of the statements of financial position and cash flows, rather than as a category within the financing section.

The Board did not express an interest in exploring a supplemental schedule that would provide information about how wealth is allocated to capital providers or a supplemental schedule that would present equity items (and possibly financing liabilities) at fair value.

Accounting standards for small and medium-sized entities

Paragraph 15 of IAS 12 *Income Taxes* establishes a general principle that a deferred tax liability should be recognised for all taxable temporary differences. However, paragraph 15(a) provides a special exception from that general principle for the initial recognition of goodwill. As a result of that exception, a deferred tax liability is not recognised on initial recognition of goodwill.

Based on a tentative Board decision in September 2006, the pre-ballot draft of an Exposure Draft of an IFRS for SMEs that was sent to the Board in December 2006 proposed the same general principle as in paragraph 15 of IAS 12 but without the special exception.

In their comments on that pre-ballot draft, some Board members noted that the question of whether, and in what amount, deferred tax should be recognised on initial recognition of goodwill is under study in the IASB's convergence projects on income taxes and business combinations. They suggested that it was therefore premature to reach a decision on the issue for SMEs alone.

The Board decided that the Exposure Draft should propose the same special exception as is in IAS 12, namely that an SME should not recognise a deferred tax liability for taxable temporary differences associated with the initial recognition of goodwill.

The Board also decided to require disclosure of the aggregate amount of temporary differences associated with the initial recognition of goodwill for which deferred tax liabilities have not been recognised.

IAS 24 *Related Party Disclosures*

The staff presented four sweep issues that arose from Board members' comments on the pre-ballot draft of the Exposure Draft of Amendments to IAS 24 *Related Party Disclosures*.

IAS 24 is inconsistent in the way it considers key management personnel. IAS 24 identifies as a related party significant investees of the entity's key management personnel. However, IAS 24 does not identify the entity that the key management personnel manage as related parties to those investees. The Board decided to address this inconsistency by broadening the definition of a related party to include the latter case.

The proposed amendments to IAS 24 will include an exemption from the disclosures required by paragraph 17 for entities that are state-controlled or under significant influence by a state. If influence exists between the two related parties, the exemption will not apply. The Board tentatively decided that if any indicators of influence exist then the entity is not exempted.

The board also decided to clarify that a related party transaction includes future commitments. Finally, the Board decided that in response to requests for urgency from constituents, and given the nature of the proposed amendments, the comment period would be 90 days rather than the 120 days originally proposed.

IAS 37 redeliberations

The staff summarised the outcome of the round-table discussions on the Board's tentative conclusions reached after redeliberating issues associated with the liability recognition and measurement principles proposed in the Exposure Draft of Proposed Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits* (ED).

The Board also considered its approach to the next stage of this project. The Board began by affirming the project objective underpinning the liability recognition principle in the ED—namely, to analyse items currently described as 'contingent liabilities' in terms of liabilities, as defined by the *Framework*.

In the light of the comments received at the round-tables, the Board decided that the following issues require further research and debate:

- how to distinguish between a liability and a business risk
- how to handle uncertainty about the existence of a present obligation (including constructive obligations)
- whether all uncertainty about the outflow of economic benefits required to settle a liability can be reflected in measurement
- what guidance to provide on the building blocks of an expected value calculation
- what special considerations might be needed for lawsuits
- disclosure about items that do not satisfy the definition of a liability (ie items currently described as 'possible obligations').

The Board acknowledged that there are important links between the issues it plans to address in this project and those in other projects (especially the conceptual framework and revenue recognition projects). Nonetheless, the Board decided that its work on this project need not await completion of other projects.

Lastly, the Board approved the provisional timetable for the next stage of the project. The timetable prioritises the six issues listed above. As a result, the Board does not expect to start redeliberating other aspects of the ED (contingent assets and reimbursement rights, restructuring provisions, termination benefits and onerous contracts) until 2008. The timetable also allows time for the Board to debate the need for additional procedures such as field visits and/or re-exposure and to consider the cost and benefits of its proposals.

Fair value measurements

The Discussion Paper *Fair Value Measurements*, published on 30 November 2006 invites comments by 2 April 2007. Some constituents are concerned that the comment period coincides with the main corporate reporting period. As a result they may not have sufficient time to consider the discussion paper and prepare a thorough response. The Board considered these comments and decided to extend the comment period to Friday 4 May 2007.

Intangible assets

The Board considered a draft agenda proposal to add a project on intangible assets to the Board's agenda. Consistently with the Memorandum of Understanding between the FASB and the IASB, the proposal aims to facilitate a Board decision by December 2007 on the scope and timing of the proposed project. The proposal was made in the context of the five agenda criteria set out in the IASB Due Process Handbook.

The Board confirmed its October 2006 decision that the scope of the agenda proposal should include:

- the initial accounting for intangible assets other than intangible assets acquired in a business combination (including internally generated intangible assets); and
- subsequent accounting for all intangible assets.

These topics have the greatest potential to result in improvements to the present requirements. The project would not encompass the requirements for the initial accounting for intangible assets acquired in a business combination, or the initial and subsequent accounting for goodwill.

It is expected that a revised agenda proposal will be considered by the IASB at its March 2007 meeting and then jointly by the IASB and FASB in April 2007. An objective is to present the proposal to the Standards Advisory Council (SAC) for preliminary discussion in June, to the Trustees in October, and to the SAC for final consideration in November.

Short-term convergence: income taxes

The Board discussed the treatment under IAS 12 *Income Taxes* of an investment allowance (tax depreciation) in excess of the purchase price of an asset. The Board noted that arguments could be made for several possible treatments. The Board instructed the staff to examine whether the accounting for investment allowances and similar tax benefits could be clarified without delaying publication of the exposure draft. The Board also noted the need for a definition of investment tax credits.

The Board also tentatively decided to clarify that the tax base of an asset is determined by the amount deductible by the entity if it sold or otherwise disposed of the asset for its carrying amount at the balance sheet date.

Update on IFRIC activities

The staff reported on the IFRIC's January meeting, details of which are published in IFRIC *Update*. One item related to the application of IAS 18 *Revenue* to initial fees charged by fund management groups and other entities. Despite agreement among IFRIC members on some IAS 18 principles to be applied to such fees, the IFRIC was unable to agree on the further principles that would be necessary for it to reach consensus on an Interpretation. The IFRIC has debated the issues for three consecutive meetings without prospect of a consensus. Therefore in accordance with the IFRIC *Preface* that indicates the IFRIC will consider only issues on which timely guidance can be given it decided to discontinue its work on this topic.

Management commentary

At this meeting, the Board discussed a summary of the comment letters received in response to the Discussion Paper *Management Commentary* prepared for the IASB by staff of the United Kingdom, New Zealand and German standard-setters, and the Canadian Institute of Chartered Accountants. The discussion paper was published by the IASB in October 2005. Overall, the response received from the publication of the discussion paper was positive. The Board asked the team to prepare a draft agenda proposal for review. The Board thanked the team for their work. See IASB Observer Notes for this meeting for the Comment Letter Summary.

Meeting dates: 2007

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

2007

19—23 February

19—23 March

16—20 April

23—24 April (joint with FASB)

14—18 May

18—22 June

16—20 July

17—21 September

15—19 October

22—24 October (joint with FASB), Norwalk, Connecticut, USA

12—16 November

10—14 December

