BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

September 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 18 – 21 September, when it discussed:

- Conceptual framework
- Short-term convergence: earnings per share
- Fair value measurements
- Annual improvements process
- Update on IFRIC activities
- Financial instruments puttable at fair value and obligations arising on liquidation
- Technical plan
- Post-employment benefits
- IAS 24 *Related Party Disclosures*
- Accounting standards for small and medium-sized entities
- IFRS 1 amendments

Conceptual framework

Phase D *Reporting Entity*

The Board discussed sweep issues arising from comments received on the pre-ballot draft of a discussion paper on the reporting entity phase of the project.

Most of the comments related to the first section of the discussion paper, which focuses on general issues. As a result, the staff had redrafted that section, and included a revision of the description of a reporting entity as a circumscribed area of business activity of interest to present and potential investors and creditors. The Board agreed with how the staff had dealt with the comments, subject to some clarification.

The Board also confirmed that there were no further sweep issues to be discussed before proceeding to publication of the discussion paper.

Phase A *Objective and Qualitative Characteristics of Financial Reporting*

The Board discussed the role of stewardship in the objective of financial reporting and the exposure draft on *The Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information.* The Board tentatively decided:

The objective of general purpose external financial reporting is to provide financial information about the reporting entity that is useful to current and potential investors and creditors and others in making decisions in their capacity as capital providers. This objective will encompass information that is useful to owners acting in their capacity as owners as well as for investing and lending decisions.

The exposure draft should be structured as follows:

(a) The basic perspective underlying financial reporting is that of the reporting entity

(b) That perspective involves reporting on the entity's resources (assets), the claims on the entity's resources (liabilities and equity), and the changes in them.

(c) The primary user group comprises those who have a claim (or potentially may have a claim) on the entity's resources—its present and potential equity investors and creditors (capital providers). Other potential users may benefit from financial reporting information, but they are not the focus of the objective.

(d) The primary user group is interested in financial information because that information is useful in the decision making of investors and creditors in their capacity as capital providers.

(e) The decisions made by investors and creditors include resource allocation decisions as well as decisions relating to protecting or enhancing their claim on the resources of an entity.

The Board directed the staff to commence drafting an exposure draft for Phase A to reflect the tentative decisions made.

Short-term convergence: earnings per share

The Board tentatively decided at its meeting in March 2007 to make changes to the calculation of earnings per share (EPS). At this meeting the Board considered the application of the proposed changes to forward purchase contracts with or without remittance of dividends.

The Board tentatively decided that shares subject to a repurchase should be viewed as a separate class of ordinary shares and that the two-class method should therefore be applied for the calculation of EPS. The Board observed that, as a consequence, the calculation of EPS for forward purchase contracts under IFRSs and US GAAP will converge.

The Board considered further the calculation of EPS for forward purchase contracts with a choice of gross physical or net settlement, gross physically settled written put options and written put options with a choice of gross physical or net settlement. The Board observed that the calculation of EPS for those financial instruments under IFRSs and US GAAP differs because of differences in the underlying accounting, and tentatively decided not to align that calculation with US GAAP.

Fair value measurements

The staff gave an update on the formation of the FASB's Valuation Resource Group. No decisions were made at this meeting.

ISSN 1474-2675

Annual improvements process

The Board considered three sweep issues arising from the ballot review process. The annual improvements project is intended to eliminate inconsistencies between standards and to clarify wording. The first exposure draft will be published in October 2007.

Reclassification of financial instruments into or out of the category 'at fair value through profit or loss'

One Board member noted that the proposed amendment to IAS 39 *Financial Instruments: Recognition and Measurement* in respect of this issue would allow an entity to transfer a financial instrument into the fair value through profit or loss category at any time after initial recognition. That Board member noted that this was inconsistent with previous decisions that the Board had taken in respect of the fair value option. The Board confirmed the wording of IAS 39 paragraph 50 that the classification of non-derivative financial instruments as held for trading, and thus accounted for at fair value through profit or loss, should be available only at initial recognition and not subsequently. The Board asked the staff to amend the proposed improvement to reflect this decision.

Replacement of the term 'fall due' with 'expected to be settled'

A Board member noted an unintended consequence of one of the proposed amendments to IAS 19 *Employee Benefits*. It related to the proposal to improve the consistency in the terminology used in describing short-term employee benefits and other long-term employee benefits. The Board tentatively agreed to amend the proposed improvement to focus on the timing of the employee's entitlement to the benefit rather than the expected timing of the employee's use of the benefit.

Miscellaneous wording revisions

The Board considered and tentatively agreed to some minor wording changes intended to improve the clarity of paragraph 36 of IAS 41 *Agriculture*.

Update on IFRIC activities

The IFRIC chairman reported on the IFRIC's meeting in September. He pointed out that details of the meeting had been published in IFRIC *Update*, which was available on the IASB Website.

The IFRIC had continued its discussions on customer contributions, non-cash distributions to shareholders and group cash-settled share-based payment transactions. The IFRIC plans to consider draft interpretations relating to customer contributions and non-cash distributions to shareholders at its next meeting. As part of its recommendations, the IFRIC is likely to propose changes to standards in respect of non-cash distributions to shareholders and group cash-settled share-based payments. Therefore, the Board would be required to vote before the IFRIC could publish its recommendations for comment.

On two issues related to IAS 39, the IFRIC staff is undertaking further analysis. Once that analysis is complete, the IFRIC will consider whether it should recommend to the Board changes to IAS 39 to help remove diversity in practice.

The IFRIC reached final decisions to recommend that the Board, as part of its annual improvements process, include further guidance on identifying whether an entity is acting as an agent or a principal in IAS 18 and clarify the interaction between the disclosure requirements of IFRS 5 and other standards.

Financial instruments puttable at fair value and obligations arising on liquidation

The Board published the exposure draft *Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation* in June 2006. The comment period ended in October 2006. An analysis of the 87 comment letters received was presented to the Board in January, and since then the Board has deliberated the issues raised by respondents.

At this meeting the Board considered a modified approach to identifying whether puttable financial instruments are the residual interest in an entity and therefore should be classified as equity under the proposed amendment. The modified approach assesses whether the class of puttable instruments is the residual interest in the entity. The approach in the exposure draft assessed whether the individual puttable instrument is a residual interest in the entity. Consideration of the class of puttable instruments as a whole eliminates the need for the criteria in the exposure draft that each puttable instrument should be issued and redeemed at the fair value of the pro-rata share of the net assets of the entity.

The Board tentatively decided to make two changes to the criterion in the exposure draft that the puttable financial instrument's right to a pro rata share of the net assets of the entity is neither limited nor guaranteed, to any extent, before or at liquidation. The first change would require the total cash flows over the life of the puttable instruments to be based substantially on the earnings or change in net assets of the entity. The second change would ensure that no other contract represents the residual interest in the entity.

The Board directed the staff to draft the proposed amendment based on this revised approach, also the Board decided to hold a public round-table discussion in November to discuss the revised approach.

The Board redeliberated several other issues, and tentatively decided that:

- the accounting for mandatory dividends will not be addressed in the proposed amendment.
- derivatives on puttable instruments and instruments with an obligation arising on the liquidation of an entity will not be classified as equity in the proposed amendment
- puttable instruments that are mandatorily redeemable on death or retirement will be within the scope of the proposed amendment.
- the proposed amendment will have an effective date of 1 January 2009, with early adoption permitted.

Technical plan

The Board made its quarterly review of its Technical Plan. The Plan sets out the expected timetable over the coming 18-24 months for projects on the IASB's active agenda. The Board publishes the revised timetable on its Website following each review. Updated project summaries are available on the IASB Website at: http://www.iasb.org/Current+Projects

Post-employment benefits

Definitions of benefit promises

The Board continued its discussion of the definitions of benefit promises. The staff proposed the following definitions:

- A *defined return* promise is a *post-employment benefit* accumulated through a contribution amount which, for any given period, can be expressed independently of the salary that will be earned after the end of that period. For some *defined return* promises the entity may have an obligation for the promised return on the contribution amount. The promised return is a guaranteed fixed return, the change in the value of an asset, or group of assets, the change in value of an index, or any combination of these.
- A *defined benefit* promise is a post-employment benefit that is not a *defined return* promise.

The Board suggested some editorial changes to clarify its intentions. It also tentatively decided to include the former *defined contribution* promises in the *defined return* category, and asked the staff to consider whether, in the light of this change, a new term would be more appropriate than *defined return* for this category of benefit promises.

The Board noted that a full explanation would be required in the discussion paper to make it clear that the accounting for a former *defined contribution* promise, in which the contributions relating to employee service in the current period are due immediately and are paid when they are due, would not be changed.

The Board also tentatively decided to treat *defined benefit* promises as the residual category of benefit promises and to address the accounting for post-retirement medical plans in Phase II of the project.

Measurement of the defined return promises

The Board discussed whether the employer's liability for the contribution requirement and the promised return in defined return promises should be measured at fair value assuming the benefit promise does not change.

The Board noted that there are some types of defined return promises that are similar to derivatives or embedded derivatives and that a fair value measure would be necessary for a faithful representation of the benefit promise.

The Board discussed whether the notion of *fair value assuming the benefit promise does not change* would be best expressed by stating that the unit of account for the fair value measurement is the benefit promise assuming no future changes, even though some do not consider this amount to be fair value of the benefit promise.

Therefore, the Board suggested that the discussion paper include a building block approach to measuring defined return promises, similar to the approach used in the Insurance project. However, the discussion paper should not offer a view on whether the appropriate measure for defined return promises is fair value. The definition of fair value will be addressed in the Fair Value Measurement project.

Distinguishing between defined return and defined benefit promises and measurement of benefits in the payout and deferment phases

The Board noted that most employment benefit promises can be viewed as having three distinct phases:

- An accumulation phase during which the employee renders service in exchange for the promise of remuneration in the future. This phase ends when the employment ceases.
- A deferment phase, which occurs after the employee has ceased employment but before the benefit payment has started (eg during a pension deferment period or a sickness waiting period).
- A payout phase during which the employer's liability to the employee for previously deferred remuneration is settled.

The Board discussed whether the definitions of benefit promises should refer only to the accumulation phase. The Board noted that the effect of longevity risk was significant and asked the staff to consider further the effect if any, of this, on the categorisation of benefit promises.

The Board also discussed how benefits in the deferment and payout phases should be measured. The Board noticed that because the accounting for post-employment benefit promises uses a mixed measurement model, it will consider two options:

- Option 1 - All benefits in the deferment or payout phase to be measured the same as defined benefit promises regardless of whether they were accumulated as defined return or defined benefit promises. In this option, gains and losses may arise when an employee with a defined return benefit promise retires.
- Option 2 - The distinction between benefit promises is maintained in the deferment and payout phases. In this option, an entity could have the same obligation to pay a given pension amount measured differently depending on whether the pension was accumulated as a defined return or a defined benefit promise

The Board deferred its decision on this pending further staff analysis.

IAS 24 *Related Party Disclosures*

The staff outlined the issues raised in comment letters on the proposed amendments to IAS 24–*State-controlled Entities and the Definition of a Related Party*, and presented a preliminary project plan.

The Board discussed the issues raised in the comment letters and made some comments and suggestions for future redeliberations. The Board considered and approved the preliminary project plan.

The Board will start redeliberating the proposed amendments to IAS 24 at its next meeting.

Accounting standards for small and medium-sized entities

The Board decided to extend the deadline for comments on the proposed IFRS for SMEs to 30 November 2007. The deadline for submitting field test results is also extended to 30 November 2007. The Board decided to extend the comment deadline primarily to allow entities participating in the field tests and those assisting such entities more time to prepare their comments on the exposure draft. The Board strongly encourages entities and organisations that are not involved in the field testing to submit their comments on the exposure draft by the original 1 October 2007 deadline.

IFRS 1 amendments

The Board began redeliberating the exposure draft of proposed Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*—Cost of an Investment in a Subsidiary.

Deemed cost

The exposure draft proposed permitting a parent to establish a deemed cost for its investment in a subsidiary in its separate financial statements on transition to IFRSs. That deemed cost could be either the transition date fair value of the investment or the carrying amount of the net assets of the subsidiary, using the carrying amounts that IFRSs would require in the subsidiary's balance sheet.

In the light of comments from respondents, the Board determined that if a net assets measure was to be used it should be the amounts that the parent incorporates in its consolidated financial statements (rather than the amounts recognised in the separate or individual financial statements of the subsidiary).

It was not clear to the Board, however, that this would address respondents concerns that proposed deemed cost exemption would not reduce the cost of adopting IFRSs in the separate financial statements of a parent sufficiently to justify adoption. Accordingly, the Board asked the staff to consult respondents to the exposure draft to establish whether the revised net assets measure would resolve their concerns.

The Board tentatively decided that, unless its net asset approach addresses the concerns of respondents, deemed cost could be measured as the carrying amount of the investment under previous GAAP.

Scope of the amendments

The Board tentatively decided to extend the deemed cost exemption on transition to IFRSs to the initial measurement in the parent's separate financial statements of investments in associates and interests in joint ventures.

Amendments to IAS 27 *Consolidated and Separate Financial Statements*

The Board tentatively decided to amend IAS 27:

- to remove the definition of the cost method from paragraph 4
- to require a parent to recognise as income in its separate financial statements all dividends it receives from a subsidiary and to assess for impairment the carrying amount of its investment in that subsidiary (in accordance with IAS 36 *Impairment of Assets*) upon receipt of such a dividend.

The Board decided that the proposed changes should be re-exposed.

Future Board meetings

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

2007

15—19 October

22—23 October (joint with FASB), Norwalk, Connecticut, USA

12—16 November

10—14 December

2008

21—25 January

18—22 February

10—14 March

14—18 April

21—22 April (joint with FASB)

19—23 May

16—20 June

21—25 July

15—19 September

13—17 October

20—22 October (joint with FASB), Norwalk, Connecticut, USA

17—21 November

15—19 December