BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

November 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 13 – 16 November, when it discussed:

- Revenue recognition
- Insurance
- IAS 24 *Related Party Disclosures*
- Share-based payment
- Update on IFRIC activities
- Financial statement presentation
- Consolidation
- Business combinations
- Puttable financial instruments and obligations arising on liquidation
- Fair value measurements
- Conceptual framework

Revenue recognition

At the October joint meeting of the IASB and FASB, the staff provided a summary of two revenue recognition models that have been developed over the past year by the staff and a group of board members (drawn from both boards). At this meeting, the principal objective was to begin considering one of those models in greater depth.

In the model considered at the meeting, revenue arises from recognising and explicitly measuring increases in specified assets and decreases in specified liabilities, rather than from a separate evaluation of how much performance occurred in a period. In other words, the amount of revenue to be recognised is determined by considering how much assets and liabilities change in a period.

The specified assets and liabilities in the model are those that arise directly from enforceable contracts with customers. A contract can be either an asset or a liability of the entity, depending on the remaining rights and obligations in the contract. A contract would be an asset (a contract asset) of the entity if the remaining rights exceed the remaining obligations. A contract would be a liability (a contract liability) of the entity if the remaining obligations exceed the remaining rights.

To measure the contract, the underlying rights and obligations in the contract are measured at their current exit price. This is the price that a market participant would pay (or require) to obtain (or assume) the remaining rights and obligations in the contract. The contract asset or liability is measured this way at inception and subsequently.

Because the model focuses on the contract asset or liability, revenue is defined as an increase in a contract asset or a decrease in a contract liability that results from the provision of goods and services to a customer. Hence, revenue is recognised when:

- an entity obtains a contract in which the underlying rights exceed the underlying obligations (because this would result in a new contract asset).
- the entity subsequently satisfies its obligations in the contract by providing goods or services to the customer (because this would either increase a contract asset or decrease a contract liability).

The amount of revenue that is recognised is derived from the increase in the exit price of the contract asset or decrease in the exit price of the contract liability.

The full description of the model was included in the observer notes for the meeting, available on the Website.

The meeting was primarily educational and no decisions were made. However, the Board noted some issues for further consideration, including:

- assessing whether the model would assist users to predict future cash flows better
- clarifying when an entity has become a party to a contract, particularly if that contract is cancellable
- clarifying whether the concern about the revenue that might arise on contract inception relates only to concerns about the possibility of error in the initial measurement of the contract asset.

At its meeting in December, the Board will consider some of the presentation issues in profit or loss raised by measuring the contract asset or contract liability at current exit price. The Board will also consider whether, and if so how, the contract-based model summarised above should be extended in particular circumstances to capture a broader set of assets and liabilities than only those arising directly from the contract.

Insurance

The Board's discussion paper *Preliminary Views on Insurance Contracts* states that the project on insurance contracts will address accounting by policyholders for their rights under insurance contracts ('policyholder accounting'). However, the paper does not address policyholder accounting because the Board has not viewed policyholder accounting as a high priority.

At this meeting, the Board discussed the process for dealing with this topic. The Board noted that forthcoming responses to the FASB's Invitation to Comment on insurance contracts, published in August 2007, may provide further information on issues relating to policyholder accounting. The Board observed that its further work on accounting by insurers may benefit from insights provided by considering policyholder accounting. At this stage, the Board expects to deal with policyholder accounting in an exposure draft without first publishing a discussion paper.

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IAS 24 *Related Party Disclosures*

The Board continued its discussion of responses to the exposure draft *State-controlled Entities and the Definition of a Related Party*.

The Board tentatively decided to retain the following features of the definition of a related party proposed in the exposure draft, and related guidance:

- the definition of a state.
- the definition of close members of a person's family.
- the term 'significant voting power'.

The Board tentatively decided to make the following changes to the definition of a related party:

- to clarify that two entities are not related to each other simply because they are both significantly influenced by the same state.
- to clarify that the proposed exemption for state-controlled entities would not be available in cases of influence by a common state. The Board will not add guidance on how to identify a common state.
- to include the sponsoring employer as a related party of a post-employment benefit plan. The staff will work further on the description of the sponsoring employer, paying particular attention to issues relating to multi-employer plans.

The Board will discuss at a future meeting whether two entities are related to each other:

- when a member of the key management personnel of one entity has significant influence over the other entity.
- when a person has joint control over one entity and significant influence (or joint control) over the other entity.
- when the reporting entity is under the control, joint control or significant influence of a close family member of key management personnel of the other entity.

The Board also tentatively decided:

- to retain the example of a related party transaction in paragraph 20(j) of the exposure draft—transactions or commitments to do something if a particular event occurs or does not occur in the future. The Board confirmed that this example includes executory contracts.
- to explain in IAS 27 *Consolidated and Separate Financial Statements* that the term 'individual financial statements' refers to financial statements that are neither consolidated nor separate financial statements, as defined in IAS 27.
- to retain the following wording, currently in paragraph 14 of IAS 24: 'The identification of related party relationships is in addition to the disclosure requirements in IAS 27, IAS 28 and IAS 31.'
- not to give further guidance on the disclosure of key management personnel compensation.
- not to change the categories for disclosure in paragraph 18 of IAS 24.
- to clarify that references to an associate include the associate's subsidiaries.
- that the standard will be effective for periods beginning on or after 1 July 2009, with early adoption permitted.
- that the proposed amendments to IAS 24 will apply retrospectively.
- to amend paragraph 34 of IFRS 8 *Operating Segments*, so that entities would not be regarded as a single customer simply because they are controlled by the same state.
- not to consider in this project whether business combinations between state-controlled entities should be regarded as common control transactions for IFRS 3 *Business Combinations*.

Share-based payment

The Board discussed three possible approaches for finalising the IFRS 2 amendment *Vesting Conditions and Cancellations* in the light of issues that have arisen since the IFRS was issued. The three possible approaches are:

- to finalise the proposed amendment with no further work on the other issues
- to finalise the proposed amendment and add a separate new project to the Board's agenda to consider the other issues
- to defer finalising the amendment and add a new project to the Board agenda to consider all the issues, including vesting conditions and cancellations, as part of a single project.

The Board acknowledged that a review of the IFRS could deal with the other issues as individual amendments or interpretations. Therefore, the Board directed the staff to set up a small research group of staff and Board advisers to examine critical IFRS 2 issues, potential convergence between IFRS 2 and SFAS 123(R), and possible options for improving and simplifying the IFRS.

If the research group concludes that there is a need for the Board to add a project to its agenda, the staff will bring an agenda proposal to the Board in June/July 2008.

The amendment *Vesting Conditions and Cancellations* is expected to be issued in the first quarter of 2008.

Update on IFRIC activities

The IFRIC co-ordinator reported on the IFRIC's meeting in November. 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 and non-cash distributions to shareholders and had considered draft interpretations on both projects. The drafts will be circulated to the Board in late November or early December for negative clearance before publication. As part of its recommendations, the IFRIC will propose changes to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* in respect of non-cash distributions to shareholders. Therefore, those proposals will be presented for approval by the Board at its meeting in December.

The IFRIC reached final agenda decisions on two of the three remaining issues relating to IAS 19 *Employee Benefits*. It also reached tentative agenda decisions on five other issues. One issue, related to a scope exception from IAS 39 *Financial Instruments: Recognition and Measurement* for contracts to buy or sell an acquiree in a business combination, raised questions that the Board might consider as part of its annual improvements project.

Financial statement presentation

The Board tentatively decided that the initial discussion document should describe the Board's conceptual preference for presenting cash flow information using the direct method and explain a cost-effective way of collecting that information. The Board also tentatively decided that the document should seek input on the costs and benefits of preparing a statement of cash flows using the direct and the indirect method.

The Board tentatively decided to modify the information to be disaggregated in the reconciliation schedule (ie a reconciliation of the statement of cash flows to the statement of comprehensive income) so as to reach convergence with the FASB for the purposes of the preliminary views document. The Board also tentatively decided to separate the presentation of valuation adjustments into valuation changes that are made every period and those that are not. At a minimum, an entity would disaggregate into four components the difference between cash flows and amounts presented in comprehensive income:

- cash flows not affecting income
- accruals and systematic allocations
- recurring valuation changes
- remeasurements other than recurring valuation changes.

The Board indicated that it did not favour including information in the reconciliation schedule about unusual or infrequent events or transactions.

The Board discussed the totals and subtotals that should be required in financial statements and reached the following tentative decisions:

- A total should be presented for each category and section in each of the financial statements. Other totals and subtotals may be presented when such presentation is relevant to understanding an entity's financial position and changes in that financial position.
- Short-term items should be distinguished from long-term items in a classified statement of financial position.
- Operating assets should be distinguished from operating liabilities in the statement of financial position.
- Other comprehensive income should be distinguished in the statement of comprehensive income and a total for comprehensive income should be presented.
- The categories and sections should be presented in the same order in each of the financial statements; however, that order would not be prescribed.

Consolidation

The staff conducted an education session for the Board on the approach the staff is developing for the discussion paper on consolidation. The discussion included consideration of securitisations, conduits and other structured entities. No decisions were made.

Business combinations

The Board decided to change the effective date of the revised IFRS 3 *Business Combinations* and amended IAS 27 *Consolidated and Separate Financial Statements* to 1 July 2009, with early adoption permitted.

Puttable financial instruments 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 issues raised by respondents. In November 2007 the Board held two public round-table discussions to consider a staff draft of a proposed amendment.

At this meeting, the staff reported the outcome of the public round-table discussions. The Board will consider the issues raised in those discussions, as well as a draft of the proposed amendment, at its meeting in December. No decisions were made.

Fair value measurements

The Board discussed preliminary definitions of current entry price and current exit price. These definitions will be used in a standard-by-standard review to assess whether each fair value measurement currently required or permitted in IFRSs was intended to be a current exit price, a current entry price, or some other basis.

The Board tentatively decided that for the standard-by-standard review the preliminary definition of current entry price would be the price that would be paid to buy an asset or received to incur a liability in an orderly transaction between market participants at the measurement date. The preliminary definition of current exit price would be the price that would be received to sell an asset or paid to transfer or settle a liability in an orderly transaction between market participants at the measurement date. If a liability is transferred, it is assumed to exist beyond the measurement date; if a liability is settled, it is assumed to cease to exist at the measurement date. These preliminary definitions are subject to change in the light of the results of the standard-by-standard review and the decisions that will be made during the forthcoming deliberations on the fair value measurement project.

Conceptual framework

The Board discussed three topics relating to the measurement phase:

- A review of Milestone I, in which the measurement basis candidates were selected and defined. The Board noted that a few definitions or examples need editorial improvements.
- Revisions to the plan for the remainder of the measurement phase. The staff will present its remaining initial analysis and recommendations for Milestone II (in which the measurement basis candidates are evaluated) in a single package early in 2008. Some of the Milestone III issues (which relate to selecting measurement bases for the framework and practical considerations) will be included in Milestone II deliberations, and others will be deferred to other phases of the framework project or eliminated.
- A preview of a decision tool for evaluating and selecting measurement bases. The staff will continue its development of the decision tool for presentation to the Board early in 2008.

Future Board meetings

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

2007

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

