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International
Accounting Standards
Board

This document is provided as a convenience to observers at Standards Advisory Council meetings, to assist them in following the Council's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff paper prepared for the Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.

INFORMATION FOR OBSERVERS

SAC Meeting: **February 2007, London**

Project: **Chairman's Report to SAC February 2007**
(Agenda Paper 2A)

As members of the SAC will be aware the Board has three main strategic objectives at the present time:

- Development of a standard for SMEs.
- Encouraging more countries to switch to IFRS rather than use national standards.
- Convergence of IFRS and US GAAP.

This report highlights the significant events in the past 4 months.

Exposure Draft of SME standard

A separate presentation and discussion will take place during the SAC meeting.

The much-awaited exposure draft is expected to be published by the time of the SAC meeting. The proposed SME standard deals all the subjects on which there are IFRSs.

Publication of the exposure draft is a milestone in a detailed process of consultation about the proposed IFRS for SMEs. We have:

- Issued a Discussion paper on the approach to developing a standard for SMEs. 120 comment letters were received.

- Published a questionnaire on recognition and measurement, and received 101 responses. We subsequently held roundtable discussions with 45 of the respondents.
- Held three meetings of the Working Group assisting us with this project.
- Discussed the project at five meetings of the Standards Advisory Council, and three annual meetings with world standard-setters.

The SME project has been discussed at 27 board meetings since 2003.

Convergence programmes

Our convergence work with major economies other than the United States continues.

India

The Institute of Chartered Accountants of India has started its work towards implementation of IFRS. Many of the current Indian Accounting Standards are 'based on' International Accounting Standards (IASs) but they have not been updated for changes made to IASs or for the issue of IFRSs in recent years. We have a team traveling to India in mid February to commence discussion about convergence. I will provide an oral update at the SAC meeting.

Accounting Standards Board of Japan (ASBJ)

The next meeting between representatives of the ASBJ and the IASB will be held in Tokyo in March 2007.

China

At the SAC meeting we will receive an update on the situation in China from SAC member, Wang Jun who is Secretary-General, China Accounting Standards Committee at the Ministry of Finance in China.

Related Party Disclosure

One result of our convergence work with China and Japan is the project to amend our standard on related party disclosures.

The disclosures required by IAS 24 *Related Party Disclosures* are intended to ensure that users of financial statements receive information about the existence of related party relationships and the effects of those relationships on an entity's profit or loss and financial position. In the course of its work with the Chinese Ministry of Finance towards the convergence of Chinese accounting standards and IFRSs, the IASB has become aware of the difficulties that state-controlled entities face when applying IAS 24. The convergence work with the ASBJ highlighted concerns about aspects of the definition of a related party in IAS 24. Similar issues have also been raised by other jurisdictions and contacts around the world.

Within the next few weeks we are expecting to issue an Exposure Draft of Proposed Amendments to IAS 24 *Related Party Disclosures* State-controlled Entities and the Definition of a Related Party.

Convergence of IFRS and US GAAP

The convergence work we are undertaking fulfils our commitment as a standard-setter towards:

- the removal of the need for overseas registrants to reconcile their financial statements to US GAAP; and
- the eventual existence of only one set of high-quality accounting standards.

The removal of the reconciliation requirement depends upon the efforts and actions of many parties – including companies, auditors, investors, standard-setters and regulators. The joint work with the FASB is designed to ensure that the answers produced by IFRS and US GAAP will be substantially the same once the programme set out in the Memorandum of Understanding (MoU) between the IASB and the FASB is completed.

Accordingly a significant part of the Board's work is centred on the requirements set out in its MoU with the FASB. The IASB Work Plan and an Annual Review of the work undertaken during 2006 are attached as Agenda papers 2B and 2C. Comments on recent significant events follow.

Recent publications

Fair Value Measurements

On 30 November the IASB published a discussion paper, as the first step of its Fair Value Measurements project, which is aimed at providing consistency in the application of existing fair value requirements. The document released as a discussion paper is the recently published FASB standard, accompanied by a series of questions to enable the IASB to determine whether amendments are necessary to the standard for use in the international environment.

The discussion paper addresses requests from a number of interested parties seeking additional guidance on the measurement of fair value. The proposals would not introduce new measurements at fair value. IFRSs already require some assets, liabilities and equity instruments to be measured at fair value in some circumstances. However, guidance on measuring fair value is dispersed throughout IFRSs and is not always consistent. The IASB believes that establishing a concise definition of fair value and a single source of guidance for all fair value measurements required by IFRSs will both simplify IFRSs and improve the quality of fair value information included in financial reports. The IASB therefore added this topic to its agenda in September 2005.

In the United States the FASB has recently issued an accounting standard, SFAS 157 Fair Value Measurements, on which work was well advanced before the IASB launched its own project. SFAS 157 establishes a single definition of fair value together with a framework for measuring fair value for financial reports prepared in accordance with US GAAP. Consistently with its commitment to the convergence of IFRSs and US GAAP, the IASB decided to use the US standard as the starting point for its own deliberations.

The use of fair value in financial reporting is of great interest to preparers, auditors, users and regulators. The IASB believes that an essential ground-clearing step in the debate is to establish a clear international definition of fair value and a consistent framework for measuring it. The discussion paper is not about expanding the use of fair value in financial reporting, but about how to codify, clarify and simplify the guidance that is at present dispersed widely in IFRSs. We are therefore keen to receive views on the ideas set out in the paper.

We initially invited comments on the discussion paper by 2 April 2007. However, some constituents were 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. Accordingly the Board has extended the comment period to Friday 4 May 2007.

Segment Reporting

Also on 30 November the IASB issued IFRS 8 *Operating Segments*. The IFRS continues the IASB's work in its joint short-term convergence project with the FASB to reduce differences between IFRSs and US GAAP.

IFRS 8 arises from the IASB's comparison of IAS 14 *Segment Reporting* with the US standard SFAS 131 *Disclosures about Segments of an Enterprise and Related Information*. IFRS 8 replaces IAS 14 and aligns segment reporting with the requirements of SFAS 131.

The IFRS requires an entity to adopt the 'management approach' to reporting on the financial performance of its operating segments. Generally, the information to be reported would be what management uses internally for evaluating segment performance and deciding how to allocate resources to operating segments. Such information may be different from what is used to prepare the income statement and balance sheet. The IFRS therefore requires explanations of the basis on which the segment information is prepared and reconciliations to the amounts recognised in the income statement and balance sheet.

The IASB believes that adopting the management approach will improve financial reporting. First, it allows users of financial statements to review the operations through the eyes of management. Secondly, because the information is already used internally by management, there are few costs for preparers and the information is available on a timely basis. This means that interim reporting of segment information can be extended beyond the current requirements.

As part of its deliberations leading to IFRS 8, the IASB considered comments by a coalition of over 300 non-governmental organisations (NGOs) known as the Publish What You Pay campaign, which asked for the scope of the IFRS to be extended to require additional disclosure on a country-by-country basis. Because the IFRS was developed as a short-term convergence project, the IASB decided that country-by-country disclosure should not be addressed in the IFRS. Instead, the matter will be raised with international bodies that are engaged with similar issues.

Service concession arrangements

A third document was published on 30 November. The International Financial Reporting Interpretations Committee (IFRIC) issued an Interpretation—IFRIC 12 *Service Concession Arrangements*.

Service concessions are arrangements whereby a government or other public sector entity grants contracts for the supply of public services—such as roads, airports, prisons and energy and water supply and distribution facilities—to private sector operators. Control of the assets remains in public hands but the private sector operator is responsible for construction activities, as well as for operating and maintaining the public sector infrastructure. IFRIC 12 addresses how service concession operators should apply existing IFRSs to account for the obligations they undertake and rights they receive in service concession arrangements.

IFRIC 12 does not address accounting for the government side of service concession arrangements. IFRSs are not designed to apply to not-for-profit activities in the private sector or the public sector. However, the International Public Sector Accounting Standards Board (IPSASB—a board operating under the International Federation of Accountants) has started its own project on service concession arrangements, which will give serious consideration to accounting by grantors. The principles applied in IFRIC 12 will be considered as part of the project.

Introducing IFRIC 12, Robert Garnett, IASB member and Chairman of the IFRIC, noted:

- Long-term arrangements with the private sector are becoming an increasingly common means used by governments to discharge their public responsibilities. The complexity of such arrangements poses challenges for the consequent accounting treatment, and a wide range of parties pressed the IASB to issue guidance on the subject.
- In developing its guidance the IFRIC drew on the experience of operators involved in a variety of service concessions across the world. In recognition of the size of the project, the IASB extended the normal due process for a draft Interpretation by holding a public consultation to satisfy itself that application of the Interpretation would result in a fair

presentation of the financial position and financial performance of concession operators. The strong, positive response to that consultation satisfied the IASB that such was the case.

Exposure Draft affecting first-time adoption of IFRSs

In January the IASB published for public comment proposals to provide further exemptions from the requirements of IFRSs when they are adopted for the first time. The proposals are set out in an Exposure Draft of proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

The proposals respond to concerns about difficulties encountered by parent companies in measuring the cost of an investment in a subsidiary on adopting IFRSs. At present, IFRSs require a parent to measure an investment in a subsidiary either at its cost or at fair value. In some circumstances a parent is unable to determine cost in accordance with IFRSs but is deterred from using fair value to account for the investment by the subsequent need to measure the investment at each reporting date.

The Exposure Draft proposes to allow a parent to use a deemed cost to measure its investment in subsidiaries when it first adopts IFRSs. This deemed cost can be determined by reference to the parent's investment in the net assets of the subsidiary or the fair value of the parent's investment. The proposals also provide further relief by alleviating the need to restate the pre-acquisition accumulated profits of a subsidiary for the purposes of classifying dividends.

These proposals are the Board's response to preparers' concern about a requirement that they regard as an obstacle to adopting IFRSs. If confirmed, the proposed changes will reduce the burden on preparers on first-time adoption of IFRSs while still providing useful information users of financial statements.

The IASB invites comments on the Exposure Draft by 27 April 2007.

Roundtables

IAS 37

In November and December the IASB held five public roundtables in London, Norwalk and Melbourne, Australia. This was the Board's first public roundtable discussion in Australia. In total more than 75 organisations from 12 different countries took part in the roundtables.

The roundtables discussed 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*.

Under the existing version of IAS 37, an entity does not recognise all liabilities on its balance sheet. For example, an entity that has a 45 per cent chance of losing a lawsuit at a cost of $1 million and a 55 per cent chance of winning at a cost of $nil does not recognise a liability. But, reversing those percentages, the same entity now recognises a liability of $1 million. The ED proposed to eliminate this cliff-hanger. Instead, all liabilities within the scope of IAS 37 would be recognised on an entity's balance sheet, with any uncertainty reflected in the measurement of the liability and explained in the notes to the financial statements.

In the light of comments received at the roundtables, the Board has 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').

Measurement

During January and early February the IASB and the FASB held seven roundtable discussions on Measurement in conjunction with their joint Conceptual Framework project. The roundtables were held in Hong Kong (another first), London and Norwalk.

The discussions confirmed that there were few supporters of measuring all assets and liabilities at fair value and equally few who advocated a pure historical cost system. The debate centred on which assets and liabilities should be reflected at fair value and which at cost, and how information about changes in values could be presented or displayed in the financial statements. The comments will be reviewed by the Conceptual Framework team in their work on the discussion paper on measurement.

Working Groups

Leases

An international working group has been established to help the IASB and the FASB in their joint project to reconsider their standards on lease accounting. The group consists of senior professionals with extensive experience in the leasing industry or with responsibility for the preparation, analysis, and audit of financial statements of entities with significant leasing transactions. The members and official observers are listed in the Appendix.

In July 2006 the IASB and the FASB, in line with requests from investors and other financial reporting constituents, agreed to add a leasing project to their technical agendas. It is a joint project by the two boards and involves reconsideration of all aspects of lease accounting. The project is expected to lead to a fundamental revision of the way that lease contracts are treated in the financial statements both of lessees and of lessors. The first due process document to be published will be a joint discussion paper that expresses the boards' preliminary views. That discussion paper is expected to be published in 2008.

There is wide interest in the project, as shown by the large number of applications to join the working group. The boards were constrained in the selection of group members by the need to keep the group small enough to work effectively. However, they acknowledge that the range of different aspects of the leasing industry across the world is such that, despite the extensive experience of group members, it will be necessary to seek information and advice beyond the group. They therefore encourage other interested parties to register as observers at working group meetings, which will be open to the public, and to share their thoughts and concerns throughout the consultative stages of the project.

Employee Benefits

The IASB has invited nominations for an international working group to provide advice on accounting for employee benefits. The nominations deadline has passed. The Trustees are currently in the process of determining the membership of the group.

The project on employee benefits, to be conducted in two phases, will be a comprehensive review of the accounting required by IAS 19 *Employee Benefits*. The first phase will consider revisions that would achieve significant improvements in the short term, with a view to an interim standard being issued in three or four years' time. As the first step in its due process the IASB intends to publish a discussion paper in 2007.

The issues to be included in the first phase of the project are:

- accounting for intermediate risk plans (including cash balance plans), including definition of defined benefit and defined contribution arrangements
- smoothing and deferral mechanisms
- presentation and disclosure
- treatment of settlements and curtailments.

The proposed Employee Benefits Working Group is intended to provide a variety of expert perspectives on accounting for post-employment benefits, including those of actuaries, auditors and other experts, and preparers and users of financial statements, and regulators. The role of the working group will not be to develop proposals of its own, but to provide views and practical advice on the concepts, ideas and proposals developed by the IASB and its staff. In performing this role members of the working group will be able to offer information and practical insights from their perspectives.

Because the project is intended to be a comprehensive review of the current accounting for employee benefits guidance, the IASB expects members of the working group to be willing to set aside their existing views or practices in favour of working towards improved financial reporting. The IASB can learn from national or industry practice, but will also consider other options. The IASB's goal is a workable standard that is conceptually grounded and principle-based.

Work programme

The IASB Work Plan and an Annual Review of the work undertaken during 2006 are attached as Agenda papers 2B and 2C. I have just a few brief comments on items on the work plan. We will be pleased to answer questions at the SAC meeting.

Classification of certain puttable financial instruments as equity

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 at its January meeting. No decisions were made. The next steps will be a detailed analysis by the staff of the scope of any possible amendment to IAS 32 *Financial Instruments: Presentation*.

The proposals in the ED respond to requests from entities around the world. IAS 32 requires an instrument to be classified as a liability if the holder of that instrument can require the issuer to redeem it for cash. That straightforward principle works well in most situations. However, many instruments that would usually be considered equity, including some ordinary shares and partnership interests, include provisions that allow the holder to 'put' the instrument (to require the issuer to redeem it) for cash. The instruments are therefore considered liabilities, rather than equity, under the existing provisions of IAS 32.

The IASB and the US national standard-setter, the Financial Accounting Standards Board, are working together on a comprehensive project on distinguishing debt from equity. However, that project will take several years to complete. There are many legitimate reasons for put features, and the IASB concluded that its constituents should not be forced to await the outcome of the long-term project. It decided to propose amendments to IAS 32 so that some instruments would be classified as equity rather than as liabilities.

Under the proposed amendments, the following types of financial instruments would be classified as equity, provided that specified criteria are met:

- ordinary shares that are puttable to (ie redeemable from) the issuer at fair value;
- ordinary shares of limited life entities; and

- partners’ interests in a partnership that must liquidate upon exit of a partner (eg on retirement or death).

The amendments also propose disclosures about the instruments affected by the proposals.

Short-term convergence – borrowing costs

At its November and December meetings the Board discussed the comments received from constituents on the exposure draft of proposed amendments to IAS 23 *Borrowing Costs*. The ED proposed to eliminate the option to recognize immediately as an expense borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset.

The Board decided that it would issue the amendments to IAS 23, as exposed, with one change – inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis will be excluded from IAS 23 for cost-benefit reasons. The Board also clarified that (as proposed in the ED) the scope of IAS 23 would exclude assets measured at fair value, although it noted that entities were free to disclose information about borrowing costs that would have been capitalized if those assets had been measured at historical cost.

The staff is drafting the amended standard. The Board has acknowledged the need to consider the effective date of the amendment to minimize disruption for entities reporting in accordance with US GAAP.

***Proposed amendments to IAS 1* Presentation of Financial Statements**

Staff presented the analysis of comment letters received on the ED of proposed amendments to IAS 1 at the December Board meeting.

The exposure draft dealt with the titles of financial statements, the number of comparative balance sheets to be presented in a set of financial statements, and the segregation of owner and non-owner changes in equity. The Board reaffirmed the proposal in the ED to allow either a single statement or a two-statement approach for presenting non-owner changes in equity – the statement of comprehensive income.

The staff is drafting the amended IAS 1 and the Basis for Conclusions.

IFRIC Due Process Handbook

In May 2006 the Trustees of the IASC Foundation published for public comment a consultation document *Due Process of the International Financial Reporting Interpretations Committee Draft Handbook.* The comment period ended on 30 September 2006. After consideration of the 42 comment letters received, the Draft handbook was amended. The finalised IFRIC Due Process handbook was approved by the Trustees in January 2007, and will be published shortly.

The key change is that there will no longer be a separate Agenda Committee meeting privately and recommending to IFRIC which items should be taken on to the IFRIC agenda. The consideration of potential agenda items will take place in the public IFRIC meeting. The IFRIC will continue to publish its reasons for not adding an item to its agenda.

Leases working group

Appendix

Members:

Ann Bordelon	Vice-President of Real Estate Finance Wal-mart Stores, Inc. US
Bill Bosco	Consultant Leasing 101 US
David Maxwell	Director Classic Technology Limited UK
David Trainer	President New Constructs, LLC US
George Yungmann	Senior Vice President, Financial Standards National Association of Real Estate Investment Trusts US
Ho Soh Khim	Chief Accounting Officer Singapore Aircraft Leasing Enterprise Singapore
Iain Robertson	Manager Accounting Policy and Special Projects Canadian Pacific Railway Canada
Jan Buisman	Senior IFRS Technical Partner PricewaterhouseCoopers Sweden
Jed Wrigley	Director of International Accounting and Valuation Fidelity UK
John Bober	Managing Director GE Energy Financial Services US
Kevin Davies	Manager Technical Accounting Department Anglogold Ashanti Limited South Africa
Mark Venus	Finance Director BNP Paribas Lease Group France
Neri Bukspan	Managing Director Standard & Poor's Credit Market Services US
Peter Kilgour	Finance Director Swire Properties Limited HK
Rich Jones	Partner – National Office Ernst & Young US
Richard Richards	Group General Manager Reporting and Tax Qantas Airways Australia
Thomas Gruber	Director Accounting and Financial Reporting Daimler Chrysler Financial Services AG Germany
Thomas Schroer	Chairman, Accounting and Taxation Committee Leaseurope Germany

Observers

European Financial Reporting Advisory Group (EFRAG)

International Organisation of Securities Commissions (IOSCO)