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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: **Annual Review 2006**
(Agenda Paper 2C)

The technical programme

1. The Board's technical agenda is largely determined by the joint convergence programme being undertaken with the Financial Accounting Standards Board (FASB).

Short term convergence

2. *Segment reporting*: IFRS 8 *Operating Segments* was issued in November 2006. The IFRS adopts the management approach to segment reporting set out in SFAS 131. By enabling entities to provide timely segment information at little extra cost, IFRS 8 gives users of financial statements the opportunity to evaluate the nature and financial effects of the business activities in which the entity is engaged and the economic environments in which it operates.

3. *Borrowing costs*: The Board published an exposure draft of proposed amendments to IAS 23 *Borrowing Costs* in May 2006. The proposals in the exposure draft reduce differences between IFRSs and US GAAP by eliminating one of the two accounting treatments in IAS 23 for borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset. The application of only one method enhances comparability. The Board decided to eliminate the option of immediate recognition of such borrowing costs as an

4. expense. Instead, borrowing costs are capitalised to the extent that they are directly attributable to the acquisition, production or construction of a qualifying asset. The Board expects to publish final amendments to IAS 23 in the first quarter of 2007.

5. *Joint ventures*: The objective of this short-term convergence project is to reduce differences between IFRSs and US GAAP by eliminating one of the two treatments in IAS 31 *Interests in Joint Ventures* for accounting for jointly controlled entities. Having decided to eliminate the option of proportionate consolidation, the Board discussed the definition of a joint venture. The Board decided that a venturer should account for its interest in a joint arrangement based on the rights and obligations that arise from the contractual arrangement. If a venturer has direct interests in assets and liabilities of a joint arrangement, it should recognise its share in each asset and liability. If a venturer has an interest only in the net outcome of an economic activity using a group of assets and liabilities under joint control, it should recognise that interest using the equity method. The Board expects to publish an exposure draft of the proposals in the first half of 2007.

6. In addition, staff of the Australian Accounting Standards Board have undertaken research for a more comprehensive review of joint venture accounting. The research completed to date is a helpful input to the analysis of control in the discussion paper on consolidated financial statements that the Board expects to publish in the second half of 2007.

7. *Government grants and emission trading schemes*: During 2005 the Board decided to defer its work on revision of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and on emission trading schemes. These projects are dependent on other project work, including that on revenue and the revision of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

8. *Income taxes*: Tax is one of the largest and most common reconciling item for IFRS users registered in the US. Both the IAS 12 *Income Taxes* and the US standard SFAS 109 *Accounting for Income Taxes* require the use of the temporary difference approach. The objective of the project is to achieve convergence on the way that the temporary difference approach is applied. The boards' aim has been to achieve convergence through the elimination of exceptions to the temporary difference approach, resulting in a higher quality, more principled standard for both boards.

9. The IASB and the FASB have discussed and reached common decisions on most issues in the project. The only major aspect on which they have not been able to agree is the treatment of uncertainty relating to tax. Differences between IFRSs and US GAAP in the treatment of uncertainties in general make reaching a common decision on tax uncertainties beyond the scope of a short-term convergence project. An exposure draft is expected to be published mid 2007.

10. *Impairment*: Staff at the FASB and the IASB are undertaking analysis to determine the scope of this project, but the Board has yet to discuss this.

Other joint projects

11. The boards' goal by 2008 is to have made significant progress in areas where the current accounting practices under US GAAP and IFRSs are regarded as needing improvement. With this aim, the boards are working on 11 joint projects, seven of which are on the active agenda, and four on the research agenda.

12. These joint projects will mostly not be completed by 2008. However, the boards understand that measurable progress by 2008 would fulfil their contribution as standard setters to the SEC roadmap.

13. The joint work being undertaken also includes work on the boards' Conceptual Frameworks.

Business combinations

14. The Board continued to work jointly with the FASB on Phase II of the business combinations project, with the objective of developing a single high-quality standard on accounting for business combinations that can be used for both domestic and cross-border financial reporting. The Boards published their proposals to revise or replace their existing standards for business combinations (IFRS 3 and SFAS 141) and consolidated financial statements (IAS 27 and ARB 51) on 30 June 2005. Following a 120 day exposure period and round-tables in Norwalk and London the Boards began re-deliberating the proposals in January 2006. The Boards expect to complete their redeliberations by April 2007 and to publish the final standards, which will take effect from no earlier than 1 January 2009, in the second half of 2007. The Boards have yet to decide if any aspects of the proposals will require re-exposure.

Consolidation

15. The Board continued work on its project to publish a single IFRS on consolidation to replace IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities*. The Board tentatively decided to change the definition of control to focus on the assets and liabilities of the entity rather than the entity per se. Other topics discussed include special purpose entities, control without a majority of the voting rights (sometimes referred to as de facto control), investment companies and managed funds (fiduciary relationships). Even though this is not a joint project with the FASB, our staff have kept the FASB Board and staff up-to-date with the tentative decisions reached by the Board. As a first step in the due process the Board expects to issue a discussion paper during the second half of 2007.

Fair value measurement guidance

16. IFRSs already require some assets, liabilities and equity instruments to be measured at fair value in some circumstances. The guidance on measuring fair value has been added to IFRSs piecemeal over many years as the IASB or its predecessor decided that fair value was the appropriate measurement attribute in given circumstances. As a result the guidance is dispersed across many standards and it is not always consistent. Furthermore, the guidance is incomplete, in that it provides neither a clear measurement objective nor a robust measurement framework. This adds unnecessary complexity to IFRSs and contributes to diversity in practice. To address these issues, the IASB added a project on fair value measurements to its agenda in September 2005. Through this project the IASB aims to replace the patchwork of fair value measurement guidance in IFRSs with a single source of guidance that would apply whenever a standard requires an asset, liability or equity instrument to be measured at fair value. Because this project aims only to develop a framework for measuring fair value, it will neither introduce nor require any new fair value measurements.

17. As the first step in its deliberations, the IASB published a discussion paper on 30 November 2006. Comments on this discussion paper are due by 4 May 2007. The responses to this discussion paper will be valuable to the IASB in developing an exposure draft of an IFRS on fair value measurement guidance, which it aims to publish in early 2008. The ensuing standard is likely to be issued in 2009.

Financial statement presentation

18. This project is being conducted in stages. Segment A of the project resulted in an Exposure Draft of *Proposed Amendments to IAS 1* Presentation of Financial Statements: *A Revised Presentation* which was published in March 2006. A summary and analysis of the comments received on the ED has been presented to the Board and is posted on the website. The revised IAS 1 is expected to be published during 2007.

19. During 2006, the Board continued work with the FASB on segment B of the project. The project title has been changed to ‘Financial Statements Presentation’ to reflect that it encompasses all of the financial statements. The Board has agreed working principles for the project, which focus on the fundamental issues for presentation and display of information in the financial statements, and has discussed the application of the working principles to develop a ‘working’ format for the sections and categories for each financial statement. A discussion paper on Phase B issues is expected to be published during 2007.

Revenue recognition

20. Over the past four years, the boards have been developing an asset and liability model for revenue recognition. In this model, an entity would recognise revenue on the basis of changes in assets and liabilities, without consideration of additional criteria such as earning or realisation. The Boards have narrowed the possible implementations of the asset and liability model to two broad versions. Under one

version the performance obligations are initially measured at fair value (fair value model), and under the other they are initially measured by allocating the customer consideration amount (customer consideration model).

21. The boards are now working towards issuing a Discussion Paper later in 2007. The objective of this Discussion Paper is to establish the basic structure of what an asset and liability model would entail for revenue recognition. It will illustrate and compare both the fair value and customer consideration models, thereby demonstrating how the main issues would be resolved under each.

22. Input from constituents on the Discussion Paper will then assist the boards in the next stage of the project as they develop a single converged standard on revenue recognition.

Post-employment benefits (including pensions)

23. Post-employment benefits are an important financial reporting and public policy issue. Accounting for such benefits has long been criticised by both users and preparers of financial statements. Accordingly, in July 2006, the Board added a two-phase project to its agenda, to review all aspects of post-employment benefit accounting.

24. During the year, the Board started deliberations on the first phase, which aims to make limited, but significant, short-term improvements to IAS 19 by 2010. These include issues relating to the recognition and presentation of the components of defined benefit pension plans and the accounting for cash balance and similar plans. The Board is currently forming a project working group that will assist the staff by providing views and practical advice from a range of perspectives.

Leases

25. At its meeting in July 2006, the Board voted to add a project on lease accounting to its agenda. This project is expected to lead to a fundamental revision to the way that lease contracts are treated in the financial statements both of lessees and of lessors. No discussions were held on this project in 2006. The staff have been working on papers to bring to the boards in early 2007. A working group has been formed to help the staff in their research.

Research – Liabilities and Equity

26. The FASB has a project to develop a comprehensive standard on accounting and reporting for instruments with characteristics of equity, liabilities, or both, and assets. Such a standard would improve financial reporting by providing users with decision useful information about an entity’s obligations to transfer assets or issue shares. The FASB has developed three models that they are in the process of assessing and comparing. The IASB is monitoring the FASB’s progress.

Research – Derecognition

27. The Memorandum of Understanding between the IASB and the FASB indicates that a due process document setting out the results of staff research on derecognition should be issued by 2008. During the past year staff from both boards and a small group of board members have discussed the objective and scope of the staff-led research project on derecognition. It was agreed that the scope of the project should initially be focused on financial assets that are measured at fair value, and at a later stage the research should be extended to other areas of accounting. The staff research is considering whether the asset definition could be used as the foundation for a new approach to derecognition i.e. if a financial asset does not meet the definition of an asset to the entity, then it should be derecognized or removed from an entity's balance sheet.

Research – Financial instruments – improvement and simplification

28. In 2006 the Board and the FASB 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. The boards have commenced their work towards meeting the agreed goal.

Research – Intangible assets

29. During 2006 work commenced on developing a proposal to add a project on intangible assets to the Board's active agenda. The formal agenda proposal will be considered in 2007. The Board decided that the proposal should include the initial accounting for internally generated intangible assets and subsequent accounting for all intangible assets. These topics have the greatest potential to result in improvements to the current requirements in IAS 38 *Intangible Assets*. The Board also decided that the proposal should not encompass the initial accounting for intangible assets acquired in a business combination and subsequent accounting for goodwill.

Conceptual Framework

30. The boards continue to refine and update their existing frameworks with the objective of developing a common framework that both boards can use in developing financial reporting standards. The conceptual framework project is being conducted in 8 phases. Currently, 4 phases are active: Phase A *Objective and Qualitative Characteristics*, Phase B *Elements and Recognition*, Phase C *Measurement* and Phase D *Reporting Entity*.

31. The boards published their first due process document from the project – a discussion paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information* in July 2006 for a comment period until 3 November 2006. Collectively, the boards received

32. nearly 180 comment letters. In early 2007, the boards will commence their considerations of the comments received and redeliberations of all the major issues.

33. During 2006, the boards continued their deliberations on the definitions of an asset and a liability, and distinguishing liabilities and equity. The boards' discussions on the reporting entity phase of the project focused on determining the boundaries of an entity for financial reporting purposes, including when two or more entities should be combined or consolidated together, and presented as a group reporting entity. The boards also started to explore issues for the measurement phase of the project, which includes roundtables held in early 2007 in Hong Kong, London and Norwalk to discuss constituent views on different measurement bases, their definitions, and the boards' plans for that phase.

Other projects

Insurance contracts

34. The Board worked intensively on phase II of the project on insurance contracts and by the end of the year was close to issuing a discussion paper. The Board's Insurance Working Group met twice in 2006, and the Board is very grateful to participants for devoting so much time and expertise to the discussions.

35. The FASB plans to issue an Invitation to Comment containing the IASB discussion paper, and will use the responses in deciding whether to add this project to its own agenda.

Liabilities – revision of IAS 37

36. In February 2006 the Board started redeliberating the proposed amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits* in the light of 123 comment letters received. The Board gave priority to tackling the more fundamental concerns associated with the proposed amendments to the liability recognition and measurement principles in IAS 37. In November and December 2006 the Board held five round-table meetings in three locations – Norwalk, London and Melbourne, Australia – to invite comment on the tentative conclusions reached as a result of its redeliberations to date. The roundtables involved more than 75 organisations from 12 countries. The Board would like to thank all participants for their time and input. The Board will consider the outcome of these meetings as it continues redeliberations in the coming year.

Small and Medium-sized Entities (SMEs)

37. During 2006 the Board completed its work on an exposure draft of an International Financial Reporting Standard for Small and Medium-sized Entities (SMEs), although formal balloting and issuance took place early in 2007. The ED proposes a stand-alone set of financial reporting principles suitable for entities that do not have public accountability – that is, they are neither publicly traded nor financial institutions. Those principles are derived from full IFRSs but simplified

for SMEs based on the needs of users of SMEs' financial statements and cost-benefit considerations. The ED is accompanied by proposed implementation guidance consisting of illustrative financial statements and a disclosure checklist, as well as a basis for conclusions. Comment deadline is 1 October 2007.

Research – management commentary

38. The IASB published a discussion paper *Management Commentary* in October 2005 prepared by staff of the standard-setters of Germany, New Zealand and the United Kingdom, and the Canadian Institute of Chartered Accountants. The comment period ended on 28 April 2006. The discussion paper attracted 117 comment letters and, overall, the responses received were positive. Respondents agreed that management commentary is an integral part of financial reporting. They also agreed with the project team’s proposals on what should be included in management commentary. While a majority agreed that there is a need for requirements relating to management commentary, views are divided on the form the requirements should take: a standard or non-mandatory guidance. The Board has yet to reach tentative views on the recommendations in the discussion paper and whether to add the project to its agenda.

Research – extractive activities

39. The objective of this research project is to develop a discussion paper that considers accounting issues that are unique to upstream extractive activities in the minerals and oil & gas industries. The research is being undertaken by a team of national standard setters from Australia, Canada, Norway and South Africa. In October 2006, the Board had an education session on the research project and considered the project team's preliminary findings on suitable measurement bases for assets comprising minerals and oil & gas reserves and resources. The project team's research on measurement bases is continuing. Throughout 2006, the project team has also been working with members of the Committee for Mineral Reserves International Reporting Standards and the Society of Petroleum Engineers Oil and Gas Reserves Committee to identify the potential for achieving greater convergence or common understanding between minerals and oil & gas reserve and resource definitions. When completed, this review will assist the Board's future deliberations on the use of the reserve and resource definitions in international financial reporting.

Care and maintenance

40. Although the Board’s resources are mainly dedicated to the convergence programme and other significant projects described above, there are a number of smaller projects which aim to clarify existing standards, as implementation issues arise.

Annual improvements process

41. During the year, the Board approved a process to deal with non-urgent, minor amendments to standards (termed the ‘annual improvements process’). The purpose of the annual improvements process is to streamline standard-setting.

42. Often changes need to be made to standards that are minor in nature. However, even minor amendments require significant due process and consideration. The annual improvements process aims to reduce the burden on the Board and its constituents by publishing all minor amendments for an annual period collectively.

43. The Board will discuss proposals for improvements to standards throughout the year and make decisions about proposed solutions. In October each year, an omnibus Exposure Draft (ED) will be issued for comment. This ED will have a comment period of 90 days with a final amendments standard to be issued on 1 April each year. The effective date of the amendments is expected to be 1 January of the following year. The first omnibus ED is expected to be issued on 1 October 2007 with the resulting amendments effective 1 January 2009.

IFRS 1 amendment

44. In response to concerns that had been raised, the Board added a project to its technical agenda to consider issues relating to determining the cost of an investment in a subsidiary in the separate financial statements of a parent on first time adoption of IFRSs. In some jurisdictions, the accounting for investments in subsidiaries in the separate financial statements of a parent has not been in accordance with IAS 27 *Consolidated and Separate Financial Statements*. In these circumstances, on transition to IFRS, it is difficult to restate the cost of these investments to be compliant with IAS 27. The purpose of the project is to identify a suitable exemption to restating cost in accordance with IAS 27 in circumstances where it is difficult to do so. The Board agreed to provide relief that allows a parent to use a deemed cost for the subsidiary at the date of transition to IFRSs.

IFRS 2 amendment

45. In February 2006, the Board published an Exposure Draft of its proposals to amend IFRS 2 *Share-based Payment*. The Board's objectives, in taking on this project, were to clarify the definition of vesting conditions and provide guidance on the accounting treatment of cancellations by parties other than the entity. The Board received more than 50 comment letters and, after redeliberation, decided to finalise its initial proposals and to include additional implementation guidance. The Amendment is expected to improve application of the standard and consistency with the equivalent US standard, FAS 123 (revised 2004).

IAS 24 – related party disclosures

46. The Board considered issues concerning related party disclosures that were raised in course of convergence discussions with China and Japan. The Board has discussed changes to clarify and improve the definition of a related party in IAS 24 *Related Party Disclosures*. The Board also discussed concerns raised by constituents about the ability of state-controlled and significantly influenced entities to apply IAS 24. The Board plans to issue an exposure draft in the first quarter of 2007, dealing with these matters.

IAS 32 – puttable instruments

47. In 2006 the board published an Exposure Draft of a possible amendment to IAS 32 that proposes that financial instruments that are puttable at fair value and meet specific criteria should be classified as equity. The proposed amendment would also require some obligations that arise on liquidation where liquidation is either certain to occur (such as for a limited life entity) or will occur in specific other circumstances (such as upon the exit of a partner in a partnership) to be classified as equity. The comment deadline closed in October.

IAS 33 – Earnings per share

48. Amendments to IAS 33 *Earnings Per Share* have been considered by the Board as a result of its efforts to maintain convergence with US GAAP. IAS 33 and the US equivalent, FAS 128 *Earnings Per Share* are substantially the same. The FASB has proposed changes to the way in which options and warrants classified as liabilities are included in diluted EPS calculations. As a result, the Board is considering making similar changes to IAS 33.

International Financial Reporting Interpretations Committee (IFRIC) activities

49. Following up on their 2005 consultation on IFRIC operations, the Trustees in May 2006 published for comment a Draft Handbook on the IFRIC's due process. Comments received concentrated on two main themes: the role of the Agenda Committee and the status of the guidance contained in published notes of IFRIC agenda decisions. After considering the comments, as well as the views of the Board and the IFRIC, the Trustees decided that all meetings at which potential agenda items are discussed should be held in public. They continued to support publication of decisions not to take items onto the IFRIC agenda, observing that such guidance, although not authoritative, served a useful purpose similar to that of the implementation guidance accompanying IFRSs.

50. 2006 saw the publication of four Interpretations, three Draft Interpretations and 27 decisions not to take items onto the IFRIC agenda. The Interpretations included IFRIC 12 *Service Concession Arrangements* – by far the largest and most complex exercise that the IFRIC has undertaken. Although many commentators thought the subject too much for its resources, the IFRIC persevered with the assignment in response to appeals from European and other operators of large public-to-private service concessions, which needed guidance on the application of IFRSs to their projects. The IFRIC staff consulted closely with operators in the course of the development of the Interpretation and the Board convened a final public consultation on the subject before approving the IFRIC's proposals. Major operators with a wide variety of concessions confirmed their view that the final outcome reflected the underlying economics in a straightforward and satisfactory way and brought much needed comparability to the reporting of service concession arrangements.

51. From the early part of the year, the IFRIC's resources were strengthened to comprise four staff under the IFRIC Co-ordinator, specifically dedicated to servicing the IFRIC. On some subjects it continues to be necessary to involve a specialist IASB staff member, but the dedicated IFRIC team has significantly improved the staff's ability to maintain a steady flow of issues to the IFRIC.