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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: June 2007, London

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

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1. This report highlights the significant events in the past 4 months, and provides an update on the progress towards achieving the commitments agreed in the Memorandum of Understanding (MoU) with the FASB which sets out a roadmap for convergence between IFRSs and US GAAP. This report also deals with developments in the US impacting on the IASB.
 2. 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.

Proposed SME Standard

3. The Exposure Draft of the proposed SME Standard was published in February 2007, around the time of the last SAC meeting. The comment deadline is 1 October 2007. The Exposure Draft has been translated into Spanish and French. A German translation is expected to be published in June 2007.
4. The aim of the proposed standard is to provide a simplified, self-contained set of accounting principles that are appropriate for smaller, non-listed companies and are based on full International Financial Reporting Standards (IFRSs), developed primarily for listed companies. By removing choices for accounting treatment, eliminating topics that are not generally relevant to SMEs and simplifying methods for recognition and measurement, the resulting draft standard reduces the volume of accounting guidance applicable to SMEs by more than 85 per cent when compared with the full set of IFRSs. As a result, the Exposure Draft offers a workable, self-contained set of accounting standards that would allow investors for the first time to compare SMEs' financial performance across international boundaries on a like for like basis.
5. A field test "kit" has been developed. The proposed Standard will be field tested during the comment period.
6. The projected publication date for the Standard is the second half of 2008.

Extending the adoption of IFRSs – convergence initiatives

7. In the last three months meetings regarding convergence have been held with the representatives of the Accounting Standards Board of Japan at which it was agreed that the IASB and the ASBJ would work together to ascertain whether it would be possible to accelerate the convergence programme. Further meetings are expected to be held later this year.
8. Representatives of the Indian Accounting Standards Board will come to London in June a few days after the SAC meeting.

9. Warren McGregor and I recently attended the regional standard setters meeting held in Manila attended by representatives of the standard setters from Brunei, Indonesia, Malaysia, Philippines and Taiwan. I will provide an oral report on these discussions at the SAC meeting.
10. One of the major factors driving the convergence initiatives in Japan, India, China, Korea, and other major economies is the equivalence exercise being undertaken by the European Commission and the Committee of European Securities Regulators. The EU must decide by 2009 whether to require reconciliations for accounting systems not deemed as equivalent. This has focussed energy on the need to reach conclusion on the convergence programmes described in a timely manner.

Convergence and IASB Work Plan

11. Attached to this report is the draft of the IASB Work Plan which will be considered by the Board at its June 2007 meeting (Attachment 1). The Work Plan reflects the objectives of the Memorandum of Understanding (MoU) with the FASB which sets out a roadmap for convergence between IFRSs and US GAAP.
12. Before discussing the progress on the technical convergence programme laid out in the MoU, it is worth noting that the US Securities and Exchange Commission (SEC) has now signalled the next steps on its consideration of IFRS use in the US market. In its 24 April press release, the SEC announced:

The Commission anticipates issuing a Proposing Release this summer that will request comments on proposed changes to the Commission's rules which would allow the use of IFRS in financial reports filed by foreign private issuers that are registered with the Commission. The approach in the proposed rule would be to give foreign private issuers a choice between IFRS and U.S. GAAP. In addition, the Commission plans a Concept Release relating to issues surrounding the possibility of treating U.S. and foreign issuers

similarly in this respect by also providing U.S. issuers the alternative to use IFRS. Comments on both would be due in the fall.

13. While the proposed rule keeps the SEC on course with the roadmap announced in 2005, the announcement of the Concept Release has had a major impact in Europe and elsewhere, emphasising the US's commitment to the development of IFRSs and their adoption.

14. Eleven major projects are included in the MoU:

- Business combinations
- Consolidation
- Fair value measurement guidance
- Financial statement presentation
- Revenue recognition
- Post-retirement benefits
- Leases
- Derecognition
- Financial instruments
- Intangible assets
- Liabilities and equity.

15. The Boards are also undertaking a joint project to develop a converged conceptual framework, and a number of short-term convergence projects to eliminate major differences between IFRSs and US GAAP.

16. Other projects on the IASB Work Plan include insurance contracts, liabilities (amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) and a number of smaller amendments to standards.

Business combinations

17. The MoU requires the IASB and the FASB, by 2008, to have issued converged business combinations standards.

18. The next milestone in this project is the issuance of a revised IFRS 3 *Business Combinations* and amendments to IAS 27 *Consolidated and Separate Financial Statements*. Achieving this milestone would accomplish the MoU objective.
19. The drafting of these documents is in progress. The staff expects to ballot the documents by 30 June 2007, with a publication date in the third quarter of 2007 to allow time for the publication process to be completed.
20. There will be a separate session at the SAC meeting outlining the changes that each Board has made to its existing standards, and outlining the feedback statement the IASB is preparing showing how the Boards have considered comments received during the consultations about the business combinations project.

Consolidation

21. In June 2003, the IASB added a project on consolidation to its agenda. The goal of the project is to publish a single IFRS on consolidation to replace IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities* such that the control criteria within a single IFRS should be developed for all entities, including SPEs.
22. The project is being developed on the basis that consolidated financial statements should report the financial results of a parent and its subsidiaries as if they were a single economic entity. Identifying whether an entity is a subsidiary should be based on the notion of control. The Board has tentatively decided that a parent entity has a controlling interest in another entity when it has exclusive rights over that entity's assets and liabilities which give it access to the benefits of those assets and liabilities and the ability to increase, maintain or protect the amount of those benefits.
23. The next milestone in this project is to publish a discussion paper on consolidation. The main purpose of the discussion paper will be to address the control principles and criteria and to present an integrated model that would reconcile the control and risk and rewards models.

24. The current project plan envisages the publication of the discussion paper in the first quarter of 2008.

Fair value measurement guidance

25. The MoU sets out the objective of having converged fair value measurement (FVM) guidance by 2008. It was originally planned that the IASB would deliberate the FASB's FVM statement (SFAS 157) with the aim of issuing an exposure draft and invitation to comment in April 2006. There were delays in finalising SFAS 157, and the decision was taken to issue a discussion paper rather than an exposure draft. The IASB discussion paper on Fair Value Measurements was published on 30 November 2006. The Board extended the comment period by a month to 4 May 2007.

26. The staff is analysing the comment letters received on the discussion paper. Once the Board has received the comment letter analysis, redeliberation of particular issues will start. During the redeliberation phase, the Board expects to hold roundtable discussions with constituents. It is expected that an exposure draft will be published in the second half of 2008.

Financial statement presentation

27. In March 2006, as a result of its work in phase A, the Board issued an Exposure Draft of Proposed Amendments to IAS 1 Presentation of Financial Statements: *A Revised Presentation* which proposed to bring IAS 1 largely into line with the US standard—SFAS 130 Reporting Comprehensive Income. The comment period for the exposure draft ended on 17 July 2006.

28. In December 2006 the staff presented a comment letter analysis and recommendations of the changes needed to the Exposure Draft. The amended IAS 1 is expected to be published in the third quarter of 2007.

29. Main features of the amended IAS 1 are:

- Presentation of all owner changes in equity in a statement of changes in equity, separately from non-owner changes in equity.

- All non-owner changes in equity (ie comprehensive income) are presented either in one statement of comprehensive income or in two statements – a statement displaying components of profit or loss (income statement) and a second statement beginning with profit or loss and displaying components of other comprehensive income (statement of comprehensive income).
- Presentation of a statement of financial position as at the beginning of the earliest comparative period in a complete set of financial statements when the entity applies an accounting policy retrospectively or makes a retrospective restatement, or when the entity reclassifies items in the financial statements.
- Disclosure of reclassification adjustments and income tax relating to each component of other comprehensive income.
- Presentation of dividends recognised as distributions to owners (and related amounts per share) in the statement of changes in equity or in the notes.

30. It is expected that the Discussion Paper resulting from phase B of the project will be published towards the end of 2007. The staff will start drafting the Discussion Paper after the July Board meeting. The staff plans to work with a few preparers and recast their financial statements on the basis of the draft. We plan to discuss the phase B Discussion Paper with the working group before it is published.

Revenue recognition

31. The commitment under the MoU is to issue a discussion paper. We expect to publish the discussion paper early in 2008.
32. The present intention is that the discussion paper will explain two different models of revenue recognition, comparing and contrasting them, and seeking the views of constituents.

Post-retirement benefits (including pensions)

33. In July 2006, the Board added a project on post-employment benefits to its agenda. The Employee Benefits Working Group was confirmed in February 2007 and met for the first time on 5 June 2007.
34. The project is being conducted in two phases. There will be a separate session at the SAC meeting about this project.
35. The first phase deals with issues relating to recognition and presentation and cash balance plans. It is well under way. The Board has completed its discussions on recognition and presentation issues and made reasonable progress on the cash balance issues. The next milestone is the publication of a discussion paper. This is expected in November 2007.
36. The second phase will involve a fundamental review of all aspects of post-employment benefit accounting. The objective at the end of phase two is to have a common standard with the FASB.

Leases

37. Under the MoU, the IASB and FASB have undertaken to consider and make a decision about the scope and timing of a potential leasing project by 2008. This goal was achieved when the IASB and FASB added the leasing project to their respective agendas in July 2006.
38. The leasing project is expected to result in a fundamental change in accounting for leases by both lessors and lessees. The primary objective of the project is to develop a model for the recognition of assets and liabilities under lease contracts that is consistent with the framework definitions and other standards.
39. The current project plan envisages the publication of a discussion paper (incorporating the views of both Boards) in the second quarter of 2008.

Derecognition

40. The purpose of the derecognition research project is to identify one or more technically feasible solutions to the question “when should an entity derecognise an asset or liability?” that would produce more decision useful information.
41. The MoU requires the Boards to consider the results of staff research efforts on derecognition of financial instruments.

Financial instruments

42. There will be a separate session at the SAC meeting about this project.
43. The MoU requires the Boards to issue a due process document (discussion paper). The Boards agreed to the broad approach, proposed contents and draft timetable of the due process document in June 2006, and commenced detailed discussions in September 2006. The Boards have had discussions about the main components of a fair value measurement model for financial instruments and related items, and possible ways to move towards such a model. Both Boards have reached a number of preliminary views.
44. In April 2007 the Financial Instruments Working Group also discussed the possible contents of the due process document.
45. We expect to publish the due process document by the end of 2007.

Intangible assets

46. The MoU requires the Boards to consider research and make a decision whether to add a project on intangible assets to their agendas. The research work is being undertaken by staff at the Australian Accounting Standards Board.
47. At the April 2007 IASB/FASB joint meeting, the Boards considered a draft project proposal. The Boards agreed that the scope of the proposal should:
 - include the initial accounting for identifiable intangible assets other than those acquired in a business combination (with a particular focus on, but not limited to, internally generated identifiable intangible assets);

- include the subsequent accounting for all identifiable intangible assets; and
- exclude the initial and subsequent accounting for goodwill.

Liabilities and equity

48. The FASB opened discussions on liabilities and equity in 1997 and issued Statement 150 *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* as an interim solution in 2003. Given that the FASB had a pre-existing project on liabilities and equity, the FASB became the lead Board in a modified joint project.
49. The FASB are expecting to publish a preliminary views document in [date deleted]. The IASB expects to issue the FASB preliminary views document (with possible additional questions and comments) as a discussion paper.

Conceptual framework

50. The SAC is the IASB working group for the conceptual framework project. At a separate session at the SAC meeting the staff will present an update on the project, and ask the SAC for further input on the project, particularly about stewardship.

Short-term convergence projects

Government grants

51. In February 2004, the Board decided to amend IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. Initially, the objective of the project was to apply the accounting model for government grants contained in IAS 41 *Agriculture* to all government grants. In February 2006 the Board reviewed the status of the project. The Board noted some concerns about the conceptual basis of the government grant model in IAS 41, particularly in its treatment of conditional grants. The Board also noted that its work in other projects, in particular its project to amend IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, might yield insights into the appropriate treatment of obligations arising in conditional grants and, hence, enable it to develop a more robust model for accounting for government grants.

Accordingly, the Board decided to defer work on the IAS 20 project until further progress is made on those projects. The Board had previously concluded that its IAS 20 project is precedential to its emissions trading project.

Accordingly, the decision to defer the IAS 20 project meant that work on the emissions trading project was deferred.

52. The FASB added a project to its agenda on emission allowances in February 2007. It has not yet deliberated any issues, but plans to issue an exposure draft in the third quarter of 2007. In the light of this development, the staff is considering whether, and if so how, to reactivate the projects on government grants and emission rights. Therefore, the next milestones for these projects will be the agenda consultation process with the SAC at its November meeting.
53. The government grants project is included in the MoU as part of short-term convergence. The goal by 2008 is to reach a conclusion about whether major differences for government grants should be eliminated, and if so, complete or substantially complete work by then. This is an unusual convergence project because there is no US standard that covers the accounting for government grants for business entities. FAS 116 *Accounting for Contributions Received and Contributions Made* provides an accounting model for non-reciprocal transfers but excludes from its scope government grants for business entities, ie the subject matter of IAS 20. Clearly, however, no due process documents will be issued in time to meet the MoU deadline.

Joint ventures

54. The short-term convergence project on joint ventures addresses two aspects of IAS 31:
 - a. the removal of one of the two accounting treatments that exist for jointly controlled entities.
 - b. the definition of a joint venture.
55. The Board has decided:

- a. to remove the option of using proportionate consolidation to account for jointly controlled entities.
- b. that a party to a joint arrangement should recognise its contractual rights and obligations created by the arrangement. A party would recognise contractual rights to assets and contractual obligations (interests in joint operations or joint assets) in accordance with applicable standards. A party would recognise its right to a share of the outcome expected to be generated from a group of assets and liabilities subject to joint control (interest in a joint venture) using the equity method.

56. We expect to publish an exposure draft in the third quarter of 2007.

Income tax

57. The IASB has discussed and made initial decisions on all the issues in the project. However, discussion of the treatment of an investment allowance at the January meeting highlighted the fact that different forms of tax incentives (eg tax deductions, reductions in tax rates and tax credits) are treated differently under IAS 12 (and SFAS 109) even though their economic substance may be the same or very similar. The treatment of investment allowances will be discussed at the Board meeting in June, along with proposals on how to treat entities that are in-substance tax exempt because of tax refunds available on distributions. We expect to publish an exposure draft in the fourth quarter of 2007.

Insurance contracts

58. The discussion paper *Preliminary Views on Insurance Contracts* was published in early May. The deadline for comments is 16 November 2007.

59. The Board will be seeking input from the SAC at its November meeting. We ask that SAC members read the discussion paper, and become well informed so as to be in a position to provide high quality advice to the Board in November.

Liabilities

60. In the last quarter the Board discussed two of the most problematic issues identified at the IAS 37 round-tables: distinguishing a liability from a business risk and uncertainty about the existence of a present obligation (including constructive obligations and stand ready obligations). The Board also discussed issues specifically associated with lawsuits with representatives from the General Counsel 100 Group.

Other amendments to standards

61. The Board has a number of projects on its agenda which involve amendments to existing Standards.

- a. We are in the process of redeliberating issues concerning the exposure draft of amendments to IAS 32 *Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation*. Further issues will be discussed at the IASB's June meeting.
- b. At its December 2006 meeting, the Board decided to propose amendments to IAS 39 *Financial Instruments: Recognition and Measurement* to specify the risks that qualify for designation as a hedged risk; and to provide additional guidance on what can be designated as a hedged portion in a hedging relationship. The aim of these amendments is not to significantly change existing practice regarding what can be designated as a hedged item under IAS 39; rather their purpose is to clarify the Board's original intentions regarding what can and what cannot be designated as a hedged item. An exposure draft is expected to be issued in the third quarter of 2007.
- c. Amendments to IAS 33 *Earnings Per Share* are being considered by the IASB as a result of its efforts to maintain convergence with US GAAP. IAS 33 and the US equivalent, FASB Statement No. 128 Earnings Per Share are substantially the same. An exposure draft is expected to be issued in the third quarter of 2007.

- d. An exposure draft of amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* was published in January 2007. The exposure draft addresses the concern that it may be impracticable to apply IAS 27 *Consolidated and Separate Financial Statements* with full retrospective effect on transition to IFRS, thereby creating a significant barrier to adoption of IFRSs for the separate financial statements of parent companies. The proposed amendments to IFRS 1 allow a parent to use either the carrying amount of the net assets of a subsidiary (determined in accordance with IFRS) or the fair value of a subsidiary at the date of the parent's transition to IFRS as its deemed cost in the separate financial statements of the parent on transition to IFRS. The proposed amendments also allow an exemption on transition to IFRSs from restating the accumulated profits of the subsidiary at the date of acquisition for the purpose of applying the cost method in IAS 27. The Board will consider the comment letter analysis at its June meeting.
 - e. An exposure draft of proposed amendments to IFRS 2 *Share-based Payment* was published in February 2006. The proposed amendments clarify the definition of vesting conditions and provide guidance on the accounting treatment of cancellations by parties other than the entity. The finalised amendments to IFRS 2 are expected to be published in the third quarter of 2007.
 - f. An exposure draft of proposed amendments to IAS 24 *Related Party Disclosures* was published in February 2007. The comment period has recently ended. The staff expect to present a comment letter analysis to the Board in September.
62. The Board has also instituted an 'annual improvements' process to streamline the making of non-urgent, minor amendments to standards. These amendments will focus on areas of inconsistency in standards or where clarification of wording is required. We believe that if these minor amendments are processed collectively, there will be benefits to constituents and the IASB. The Board will discuss proposals for improvements to standards throughout the year and make decisions about proposed solutions. In the period to May 2007, 16 proposed amendments

had been discussed and agreed by the Board. These proposed amendments are published on the IASB website as the decisions are made. In October each year, an omnibus Annual Improvements Exposure Draft containing all the proposed amendments will be issued for comment, with a comment period of 90 days. A final omnibus list of amendments to various standards is to be issued in April each year. The effective date of the amendments is expected to be 1 January of the following year. The first annual improvements exposure draft is expected to be issued on 1 October 2007, with amendments effective 1 January 2009.

Potential agenda items

63. Each year the IASB considers potential items for addition to its agenda. Generally we do this at the July meeting, but because of the pressure of work towards meeting the objectives of the MoU we have delayed the agenda decisions for 2007 to the December meeting.

64. The IASB's discussion of potential projects and its decisions to adopt new projects take place in public IASB meetings. Before reaching such decisions the IASB consults the SAC on proposed agenda items and priorities. At the June SAC meeting there will be a separate session for a preliminary discussion on a number of potential projects:

- a. Intangible assets
- b. Management commentary
- c. Common control transactions.

The reactivation of the work on emission rights will also be considered. The fully developed agenda proposals will be brought to the SAC November meeting to complete the consultation process.

Use of the term IFRS in describing the basis for accounting

65. We are having discussions with the regulators (representatives from both CESR and IOSCO) and the International Auditing and Assurance Standards Board in an

endeavour to reach a mutually agreed solution to this issue. Such a solution is likely to require action by both the standard setters and the regulators. Further meetings are scheduled for late June and July.