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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**16 October 2007, London**
Project:	**Conceptual Framework**
Subject:	**How will the new chapters of the new framework interact with the existing *Framework*? (Agenda Paper 5)**

PURPOSE OF THIS PAPER

1. At the September 2007 meeting, the IASB and FASB directed the staff to commence drafting an exposure draft of Chapters 1 and 2 in the new joint framework. However, the boards have yet to discuss how will new chapters in the new framework fit and impact the existing *Framework* or Concept Statements for future standard-setting work, while waiting for the new framework to be completed. At the October 2006 meeting, the IASB and FASB agreed that *each Board*, within the context of its current GAAP hierarchy, will finalise the common framework as parts (chapters) are completed. Therefore, this memo is only directed to the IASB.

2. The purpose of this paper is for the Board to decide policy issues relating to the interim period while waiting for the new framework to be completed. Specifically, the Board is asked:

   a. Should we withdraw the relevant paragraphs on the objective and qualitative characteristics in the existing *Framework* when we finalise Chapters 1 & 2?

b. Should we change the term "reliability of measurement" in the existing *Framework* to a different term?

c. Do you agree that amendments arising from the new framework should not result in changes to IASB's pronouncements?

d. Should the Board apply the new chapters immediately when finalised?

e. Should constituents have a separate effective date from the Board when the chapters in the new framework are finalised? For phase A, should constituents have the same effective date as the Board?

3. In deciding on their answer to the questions above, Board members may also consider the current role of the *Framework* in IASB's hierarchy. Apart from assisting the Board in developing IFRSs, other purposes of the existing IASB *Framework* include: to assist preparers in applying IFRSs, particularly when there is no existing IFRS, and to assist users to interpret information contained in financial statements[1].

A HOW WILL NEW CHAPTERS FIT WITH THE EXISTING *FRAMEWORK*?

4. When we finalise Chapters 1 & 2, paragraphs 9-46 in the existing *Framework* – i.e. the sections on the objective and qualitative characteristics of financial statements – will be out of date. This leads to the question if we should:

a. Leave the existing *Framework* as it is, or

b. Withdraw paragraphs 9-46 in the *Framework* and make consequential amendments.

5. Option 4a maintains the spirit that the *Framework* was published as a single, cohesive document. This option acknowledges that it is difficult to change parts of the *Framework*. (Part B in this memo discusses an issue encountered when doing consequential amendments within the *Framework*.) If we choose option 4a, the staff suggest that we put a rubric in front of the *Framework* to note that where there is conflict, Chapters 1 & 2 will take precedence.

[1] *Framework for the Preparation and Presentation of Financial Statements* paragraph 1 and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* paragraph 10

6. For Phase A, the staff recommends option 4b. This is a less confusing option as everyone (both the Board and constituents) will be using the same document. And this factor outweighs the concerns when doing consequential amendments on the framework. However, the staff recommend that the Board also reconsider this issue when finalising other phases in the project. This is because the proposals in Phase A are not very different from what is contained in the existing *Framework*. As the staff do not have a crystal ball, we cannot predict what will happen in the other phases of the project and how different the output will be from the existing *Framework*.

Question to the Board:
7. Do you agree with the staff recommendation?

B AMENDMENTS TO OTHER PARTS OF THE *FRAMEWORK*

8. Part B of the paper assumes that the Board agrees to option 4b. Consequently, another issue arises: should we replace the term reliability in the recognition criteria in the existing *Framework*? This is because when we publish the ED, Chapter 2 will propose to replace the term *reliability* with *faithful representation*.

9. The recognition criteria in the *Framework* says:

> 83. An item that meets the definition of an element should be recognised if:
>
> i. …
>
> ii. the item has a cost or value that can measured with *reliability*.
>
> 86. The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with *reliability* as discussed in paragraphs 31 to 38 of this *Framework*. In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their *reliability*. …. [emphasis added]

10. Reasons to update the recognition criteria are:

    a. The criterion of reliable measurement may not work without the supporting material previously in the paragraphs to be deleted.

    b. The Board (and constituents) needs to know how to read the recognition criteria.

11. Reasons against a change are:

    a. It may not be possible to update the criterion of reliable measurement without considering extensive changes to the recognition criteria, beyond the reasonable scope of this phase of the project

    b. In due course, the IASB and FASB may consider dropping the criterion of reliable measurement. If so, it would be wasted effort to refine that criterion now.

Question to the Board:
12. Which option do you prefer?

C CONSEQUENTIAL AMENDMENTS TO EXISTING IFRSs?

13. Paragraph 11 in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires management to provide information that is:

    (a) relevant to economic decision-making needs of users; and

    (b) *reliable*, in that the financial statements:

    (i) *represent faithfully* the financial position, financial performance and cash flow of the entity …. [emphasis added]

14. Paragraph 5 in IAS defines prior period errors as:

    <u>Prior period errors</u> are omissions from, and misstatements in, the entity's financial statement for one or more prior periods arising from a failure to use, or misuse of, *reliable* information that:

    (i) was available when financial statements for those periods were authorised for issue; and

(ii) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

…. [emphasis added]

15. These are examples that when both Chapters 1 and 2 are finalised, there will be some inconsistencies between IFRSs and the new common framework. To deal this issue, the staff note 5 options:

    a. Amend IFRSs to be consistent with the proposed changes in the *Framework*

    b. Only update IFRSs to reflect changes in terminology

    c. Delete the term reliability completely from IFRSs

    d. Keep the term "reliability" but extract the relevant materials in the existing *Framework* and put them as a footnote to applicable IFRSs

    e. Do not amend IFRSs and acknowledge that supporting materials from the *Framework* on "reliability" will not be available.

16. The staff recommend option 15e. Reasons are:

    a. Option 15e follows the principle that the framework should not override pronouncements. Paragraphs 2 and 3 of the *Framework* say:

        2. … Nothing in the *Framework* overrides any specific International Accounting Standard.

        3. The Board of the IASC recognises that in a limited number of cases there may be a conflict between the *Framework* and an International Accounting Standard. In those cases where there is a conflict, the requirements of the International Accounting Standard prevail over those of the *Framework*. …

    b. The other options will consume more resources than currently available and delay publication of the ED. For example, option 15b which proposes to only update for terminology, may seem quite easy. However, the staff dismissed this option because such an undertaking can be a slippery slope as there is always going to temptation to increase the scope. Furthermore, although on the surface it may seem to be less work, such an undertaking will require as much work as the option to update every IFRS (option 15a) as the staff will still need to go through every part of our literature to replace the terminology.

c. If we apply the other options, this raises the question if this policy should be applied when we publish other chapters arising from the framework project. For example, if we amend the recognition criteria, do we have to update every IFRS that follows the recognition criteria in the existing *Framework*? For example, paragraph 16 in IAS 40 states:

Investment property shall be recognised as an asset when, and only when:

a. it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and

b. the cost of the investment property can be measured reliably.

Question to the Board:

17. Amendments consequence of the new framework should not result in changes to IASB's pronouncements. Do you agree?

D EFFECTIVE DATE

18. This paper considers whether an effective date for the new framework is necessary for the Board and constituents.

19. *Effective dates for the Board*: The staff do not think that the Board needs an effective date for the framework when it finalises Chapters 1 and 2, and beyond. This is because the staff think that the Board will want to start using the new framework in standard-setting as soon as possible. This is particularly useful for joint projects with the FASB.

20. *Effective dates for constituents*: For Chapters 1 & 2, the staff think that an effective date will not make any significant difference to constituents. However, when the Board finalises later chapters on recognition and measurement, the staff think that having an effective date may be necessary.

IAS 8 requires entities to apply the *Framework* when there is no explicit existing IFRSs. Moreover, there may be some jurisdictions where the existing *Framework* has been adopted as part of their law and they consider the *Framework* as a type of "standard" and will need more time to go through relevant due process. Therefore, the staff recommend that the Board consider this issue on a phase-by-phase basis.

Question to the Board:

21. Effective dates for the Board: Do you agree that the Board should apply the new chapters immediately when finalised?

22. Effective dates for constituents:

    a. For phase A, do you agree that the constituents apply the framework immediately?

    b. For other phases, do you agree that this should be considered on a phase-by-phase basis?