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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

SAC Meeting: **June 2008, London**

Project: **IASB Chairman's Report to SAC – June 2008**

(Agenda Paper 2)

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1. The development of a single set of high quality, understandable and enforceable global accounting standards for use in the world's capital markets has been the primary goal of the IASB since its inception in 2001. That aim has driven the work we have undertaken.

2. The SEC's decision in November 2007 to remove the requirement for foreign private issuers reporting under International Financial Reporting Standards (IFRS) as issued by the IASB to reconcile their financial statements to US generally accepted accounting principles (GAAP) was an important step towards achieving the aim of a single set of global accounting standards. Removal of the reconciliation was an important objective of the IASB when we agreed on the Memorandum of Understanding (MoU) with the US Financial Accounting Standards Board (FASB) in 2006, and set the 2008 targets under the MoU.

3. The time has now come to set out our programme for the next three years. We have been developing the work plan in the past few months, including a discussion at our

joint meeting with the FASB in April to establish targets to complete the work outlined in the MoU. The detailed planning will be discussed by the IASB at its meeting in June, a few days before the SAC meeting. While I have outlined the plans in this report, we will provide an update orally at the SAC meeting.

4. In planning the next three years we have taken account of needs arising from current market events, as well as considering those countries who have recently announced that they will be adopting IFRS in coming years. The current credit crisis has prompted requests for the IASB to accelerate its work in a number of areas. These are detailed in a separate paper (Agenda Paper 1) for the SAC meeting.

5. Acceptance of IFRS in 2007 was not limited to the United States. The SEC's decision follows those announced by other leading countries in 2007 to establish time lines for the acceptance of IFRS in their domestic markets or accelerate convergence of national standards with IFRS. Among those are Brazil, Canada, India and Korea, all of which will adopt IFRS by 2011. Following an agreement in August with the Accounting Standards Board of Japan, Japanese GAAP and IFRS will have converged by 2011. At the beginning of 2007 China introduced a completely new set of accounting standards that are intended to produce the same results as IFRS.

6. In addition to removing the reconciliation, the SEC has issued a Concept Release raising the possibility of treating US and foreign issuers similarly by allowing US issuers the choice to use IFRS. The SEC held roundtables on the Concept Release in December 2007 the outcome of which seemed to be at least favourable to the idea of allowing American listed companies the option of using IFRSs rather than US GAAP. There was some pressure for the SEC to set a final date for a switch over from US GAAP to IFRSs at least for all major listed companies. We are continuing to monitor the situation.

7. In summary – our work is not done, and our priority is completing our joint work with the FASB set out in the MoU. After completing those projects, the IASB will have tackled some of the most challenging conceptual and presentational issues in financial reporting. The end result will be a comprehensive set of standards – IFRS – based on clear principles, that provide transparency and usability to readers of financial statements throughout the world.

The IASB Work Plan – 2011 targets

8. The IASB and the FASB are developing a work plan for the completion of the MoU. The work plan has been developed after discussion at the joint boards meeting in April of the relative priority of the needed financial reporting improvements, the time frames for completing them, and the major milestones along the way. It will be discussed and confirmed at the June IASB Board meeting, held just before the June SAC meeting.

9. In developing the work plan we have had in mind the following objective: To outline the improvements to existing IFRS that are needed to facilitate adoption of IFRS in all major capital markets.

10. A small group comprising a board member and a director from each board developed recommendations consistent with two assumptions:

    - For capital markets not yet adopting IFRS, the target date of mandatory adoption is no later than 2013.
    - A 'quiet period' of at least a year before that target date is provided.

11. Those assumptions mean that the MoU completion plan should describe the progress that can be achieved between now and mid-2011.

12. We are trying to avoid the possibility that a company adopting IFRS in 2013 would undergo two changes in a relatively short period – the first change being the adoption of IFRS and the second change being a major revision of an IFRS standard. Thus, work completed in 2011 should be designed to allow early adoption by those who plan to adopt IFRS for the first time in 2011, but to not be required until 2013; and then to remain in place for several years; with any changes to IFRS during the 3-year period after 2011 being modest.

13. Achieving a mid-2011 completion goal will require revisions to the scope and objectives of at least some projects. The extent of those revisions will become apparent in the work plan. Finally we will consider whether the changes that we can reasonably expect to achieve by 2011 are a sufficient improvement in financial reporting to justify imposing the changes on users and preparers of financial statements.

14. The 2011 work plan includes several different categories of projects:

- Projects that address areas where fundamental improvements in IFRS and possibly US GAAP are needed – these include revenue recognition, fair value measurement guidance, and in light of the credit crisis, consolidation and derecognition.
- Projects that address areas for which there is a significant need for improvement in both IFRS and US GAAP. This group includes financial statement presentation, reducing the complexity in reporting financial instruments, distinguishing liabilities and equity, leases, post-employment benefits, income tax.
- Projects that address areas in which IFRS does not currently provide in-depth guidance. This group includes insurance contracts, the project on IAS 37 liabilities, SMEs, and accounting for extractive industries.
- Development of a common conceptual framework.

15. Finally the purpose of the MoU completion plan is to focus the agenda, and thereby the work of the IASB board and staff. We have a goal. Achieving the goal will be a challenge.

The IASB Work Plan – new agenda items

16. Each year the IASB considers potential items for addition to its agenda. Generally we do this at the July meeting, after consulting with the SAC and others.

17. At the June SAC meeting we will discuss two agenda proposals – adding projects to the Board's active agenda on Liabilities and Equity, and Derecognition. Both these projects have been on the research agenda for some time. Separate papers outline the agenda proposals.

The process of adding an item to the IASB's agenda

18. 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.

19. The development of a single set of global standards relevant to users' needs is the foremost objective of the IASB. Accordingly, the IASB evaluates the merits of adding a potential item to its agenda primarily on the basis of the needs of users of financial statements.

20. The IASB considers the following factors when adding agenda items:

    (a) The relevance to users of the information involved and the reliability of information that could be provided

    (b) Existing guidance available

    (c) The possibility of increasing convergence

    (d) The quality of the standards to be developed

    (e) Resource constraints.

21. Further details can be found in the IASB Due Process Handbook paragraphs 19 to 26, and 52 to 61. The Due Process Handbook is available on the IASB website at http://www.iasb.org/Current+Projects/IASB+Due+Process.htm.

Discussion Papers published

22. 2008 can be described as the 'Year of the IASB Discussion Paper'. We are scheduled to publish discussion papers on financial statement presentation, revenue recognition and leases later in the year, and have already published discussion papers on distinctions between liabilities and equity, post-employment benefits, and reducing complexity in reporting financial instruments.

Financial Instruments with Characteristics of Equity

23. Towards the end of February we published a discussion paper on the distinction between equity financial instruments and other financial instruments (non-equity instruments). The discussion paper is the first stage of the IASB's project to improve

and simplify the requirements in IAS 32 *Financial Instruments: Presentation*. Stakeholders around the world have raised two broad classes of criticisms of the current requirements:

- the principles in IAS 32 are difficult to apply
- the application of those principles can result in an inappropriate classification of some financial instruments.

24. The project is a modified joint project between the IASB and the FASB. In a modified joint project, one board leads the initial stage. The FASB led the research stage of this project and published a Preliminary Views document *Financial Instruments with Characteristics of Equity* in November 2007.

25. The IASB has not deliberated the proposals in the FASB document and does not have a preliminary view. The goal of the discussion paper is to solicit the views of interested parties on whether the proposals in the FASB document are a suitable starting point for the IASB's deliberations. The outcome of the consultations will be essential in determining the future direction of the project. If the project is added to the IASB's active agenda, the IASB intends to undertake it jointly with the FASB.

26. The IASB invites comments on the discussion paper by 5 September 2008.

Reducing Complexity in Reporting Financial Instruments

27. The existing requirements for the reporting of financial instruments are widely regarded as difficult to understand, interpret and apply and constituents have urged the IASB to develop standards that are principle-based and less complex. The discussion paper on reducing complexity in reporting financial instruments is the first stage in a project which aims to replace IAS 39 *Financial Instruments: Recognition and Measurement.*

28. The discussion paper analyses the main causes of complexity in reporting financial instruments and proposes possible intermediate approaches to address some of them. Those approaches seek to improve and simplify measurement and hedge accounting by amending or replacing the existing requirements. Furthermore the discussion paper sets

out the arguments for and against a possible long-term approach that would use one measurement method for all types of financial instruments in the scope of a financial instruments standard.

29. The IASB seeks views on both the possible long-term and intermediate approaches and is interested to hear about possible alternatives on how it should proceed in developing new standards for reporting financial instruments that are principle-based and less complex.

30. IAS 39, which the IASB inherited from its predecessor body, is far too complex. We are determined to simplify and improve IAS 39 by creating a principle-based standard. Those who believe in reducing complexity in accounting standards have now the opportunity to shape the way ahead.

31. The IASB invites comments on the discussion paper by 19 September 2008.

Proposals to increase transparency in the accounting for post-employment benefits

32. The discussion paper sets out the IASB's preliminary views on how the accounting for some post-employment benefits, including pensions, could be improved. It addresses the main concerns expressed by a wide range of interested parties that the accounting model set out in IAS 19 is inadequate and should be reviewed. Constituents have pointed out that:

- the deferral of the recognition of gains and losses leads to misleading figures in the statement of financial position;
- the multiple options for deferring recognition lead to poor comparability across companies;
- the lack of clarity in the definitions of benefit promises lead to inconsistencies and poor comparability for those benefit promises that include a promised return on contributions linked to an asset or an index;

- the required measurement method is inadequate for those benefit promises that include a promised return on contributions linked to an asset or an index.

33. The IASB's preliminary views on how to address those main issues are:

    - to remove the options for deferred recognition of gains and losses in defined benefit plans

    - to introduce a new classification of benefit promises into contribution-based promises and defined benefit promises, with a new measurement attribute for contribution-based promises.

34. Accounting for pensions is a complex area of huge importance. The total liability for 80 of the top companies around the world alone is estimated to be around £700 billion. In some cases, the pension liability even exceeds the market capitalisation of the company. The financial statement of a company must provide investors, analysts and companies with clear, reliable and comparable information on a company's pension obligations. It is in the interest of all of us to find ways to improve this area of financial reporting, and the discussion paper on post-employment benefits is the starting point.

35. The IASB invites comments on the discussion paper by 26 September 2008. The IASB plans to redeliberate the issues and publish an exposure draft of proposed amendments to IAS 19, with a view to issuing a revised standard by 2011.

36. The publication of the discussion paper on post-employment benefits was notable as the first occasion on which we have introduced a publication in a live Web presentation. Stephen Cooper, IASB Board member and Jenny Lee, project manager made the presentation and responded to questions from participants. In mid June, shortly before the SAC meeting, we have scheduled a live Web presentation on the financial instruments discussion paper on reducing complexity. This session will be presented by John Smith, IASB Board member and Gavin Francis, IASB Director of Capital Markets.

Conceptual framework – documents published

37. Consultative documents seeking comments on two phases of the joint IASB and FASB project to develop an improved conceptual framework were published in late May – an exposure draft of Chapters 1 and 2 of the framework (Objective and Qualitative Characteristics) and a discussion paper on the Reporting Entity concept.

38. The exposure draft of chapters 1 and 2 of the framework seeks views on an improved objective of financial reporting, the qualitative characteristics of information provided by financial reporting and constraints on the provision of that information. The draft reflects the boards' updated proposals in the light of comments received on an initial consultation document published in July 2006.

39. The exposure draft now proposes that the objective of financial reporting is to provide financial information that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. It also presents an improved description of 'faithful representation', one of the qualitative characteristics that financial information should possess if it is to provide a useful basis for economic decisions.

40. The discussion paper sets out the boards' preliminary views on the reporting entity concept and related issues. Although the reporting entity concept determines some important aspects of financial reporting, the boards' existing frameworks do not address it specifically. The boards' preliminary views are:

    - a reporting entity is a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers.

    - control is the basis for determining the composition of a group reporting entity.

    - consolidated financial statements should be prepared from the perspective of the group reporting entity.

41. The IASB and the FASB invite comments on both documents by 29 September 2008.

Other recent developments – Standards published

42. Three sets of amendments to Standards have been published since the SAC last met.

- Amendments to IAS 32 and IAS 1 *Puttable Financial instruments and Obligations Arising on Liquidation*
- Amendments to IFRS 1 and IAS 27 *Cost of an Investment in the Separate Financial Statements*
- *Improvements to IFRSs* – the result of the conclusions the Board reached on proposals made in its annual improvements project.

Amendments to IAS 32 and IAS 1 *Puttable Financial Instruments and Obligations Arising on Liquidation*

43. These amendments improve the accounting for particular types of financial instruments that have characteristics similar to ordinary shares but which are classified as financial liabilities.

44. IAS 32 requires a financial 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 financial instruments that would usually be considered equity, including some ordinary shares and partnership interests, allow the holder to 'put' the instrument (to require the issuer to redeem it for cash). Currently these financial instruments are considered liabilities, rather than equity.

45. The amendments to IAS 32 address this issue and require entities to classify the following types of financial instruments as equity, provided they have particular features and meet specific conditions:

- puttable financial instruments (for example, some shares issued by co-operative entities)
- instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (for example, some partnership interests and some shares issued by limited life entities).

46. Additional disclosures are required about the instruments affected by the amendments. The amendments will apply for annual periods beginning on or after 1 January 2009, with earlier application permitted.

Amendments to IFRS 1 and IAS 27 *Cost of an Investment in the Separate Financial Statements*

47. The amendments respond to constituents' concerns that retrospectively determining cost and applying the cost method in accordance with IAS 27 on first-time adoption of IFRSs cannot, in some circumstances, be achieved without undue cost or effort.

48. The amendments address that issue:

- by allowing first-time adopters to use a deemed cost of either fair value or the carrying amount under previous accounting practice to measure the initial cost of investments in subsidiaries, jointly controlled entities and associates in the separate financial statements; and

- by removing the definition of the cost method from IAS 27 and replacing it with a requirement to present dividends as income in the separate financial statements of the investor, together with a requirement to consider whether there is any indication that the investment may be impaired.

49. The amendments to IAS 27 also respond to queries regarding the initial measurement of cost in the separate financial statements of a new parent formed as the result of a specific type of reorganisation. The amendments require the new parent to measure the cost of its investment in the previous parent at the carrying amount of its share of the equity items of the previous parent at the date of the reorganisation.

50. The amendments to IFRS 1 and IAS 27 will apply for annual periods beginning on or after 1 January 2009, with earlier application permitted.

Improvements to IFRS

51. The IASB decided to initiate an annual improvements project in 2007 as a method of making necessary, but non-urgent, amendments to IFRS that will not be included as part of another major project.

52. The IASB's objective was to ease the burden for all concerned by presenting the amendments in a single document rather than as a series of piecemeal changes. The amendments are presented in two parts:

    - those that involve accounting changes for presentation, recognition or measurement purposes, and
    - those involving terminology or editorial changes with minimal effect on accounting.

53. Unless otherwise specified the amendments are effective for annual periods beginning on or after 1 January 2009, although entities are permitted to adopt them earlier.

54. During its deliberations of comments received on the exposure draft of proposals published in October 2007, the IASB decided to postpone reconsideration of some of the proposals until more analysis could be completed. The Board also decided to issue separately the amendment to restructure IFRS 1 *First-time Adoption of International Financial Reporting Standard*s. The amendments issued on 22 May 2008 do not include those proposals.

People

55. The Trustees have appointed two additional members of the IFRIC to increase it from 12 to 14 members. They are Peggy Smyth, Vice President, Controller, United Technologies Corp. and Scott Taub, Managing Director, Financial Reporting Advisers LLC. In addition four members of the IFRIC reach the end of their terms on 30 June. Two of these members are eligible for re-appointment.

56. We have reorganised the technical leadership team following the resignation of Liz Hickey. Liz will be returning to New Zealand in July. The new appointments are:

- Alan Teixeira will be Director of Technical Activities;
- Gavin Francis will be Director of Capital Markets;
- Peter Clark will be Director of Research;
- Paul Pacter continues as Director of Standards for SMEs;
- Tricia O'Malley changes her title from IFRIC Co-ordinator to Director of Implementation Activities; and
- Wayne Upton will be Director of International Activities.

Annual Report

57. In late May we published the IASC Foundation's Annual Report 2007. The Annual Report can be downloaded from the IASB website. Printed copies will be available at the SAC meeting.