IFRS Monitor International Standard-Setting

IASB Meeting

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CONCEPTUAL FRAMEWORK

Peter Clark (IASB director) said he wanted to discuss the process before they got on to the individual papers. He reminded the Board that this was a different approach from what had been done previously, where they had built up from individual elements over a long period. In this case they were bringing a complete package so that the Board could see things in context. The papers as written, of course, did not have any IASB views. He wanted to emphasise was what they would be publishing is a discussion paper and would focus on issues that the Board wanted to have views about and would not be as detailed as an exposure draft.

Another point on which staff wanted feedback was how much discussion should be in the papers of alternatives - probably more than were in the current papers, but the staff thought they should not mushroom. He said the staff regarded Chapters 1 and 3 of the conceptual framework as finalised but they accepted they might need to make consequential amendments as the work proceeded. There were three areas which people talked to them about and they thought people did not necessarily understand. These were stewardship, prudence and reliability. It may be that people misunderstood what the Board had meant because they had not communicated effectively.

He said that because they were working to bring a whole package they hadn't done much external consultation. The Board should bear that in mind. They were not, however, starting from scratch. Good work had been done on the earlier project and in addition Ron Lott (FASB staff) had been seconded to help them (but as a member of the IASB team not as representing the FASB) and they were hoping to have one or two people from other standard setters but that had not been finalised yet.

They were hoping the Accounting Standards Advisory Forum (ASAF) would be in place by the beginning of April and the staff would like to take the February and March papers to them. He emphasised that in publishing the discussion paper, they should make clear that the Board views were not set in stone.

Mr. Mackintosh asked how long they were going to give people to work on the discussion paper. Rachel Knubley (IASB staff) said they were going to propose a four month comment period. She added that at this meeting they would discuss papers, which taken all together, would constitute the discussion paper. The papers they would discuss were elements, liabilities and equity, recognition and de-recognition, and measurement. Each paper included a discussion of the major issues with a staff recommendation. They had not, however, asked questions on all of the issues. They had concentrated on areas which they thought were likely to be controversial but if Board members disagreed with the arguments, staff would be grateful if they would mention that and also if they saw other alternatives.

She warned that papers had different authors and were not therefore in a consistent style yet. She asked Board members to focus on the issues and not the drafting. The papers were also not complete, for example, presentation would be brought back to the March meeting.

Included with the papers was a summary of the research done by the ASBJ on the use of OCI. Their staff would present that the following morning. Also included in the set was a paper on the previous month's discussion forum on disclosure. As far as next steps was concerned, they were hoping to have a revised draft in April and then to issue the discussion paper in July. It was a pretty quick turnaround but they hoped to hit the deadline.

Philippe Danjou noted that there was a CMAG meeting scheduled, were they going to talk to them? Ms. Knubley said yes and they would also talk to the IFRS Advisory Forum.

<u>Liabilities</u>

Joan Brown (IASB staff) said that Paper 3C dealt with the issue of whether an entity had a present obligation in relation to recognising a liability. This was a difficult area and they thought it was helpful to discuss this before they discussed the definition of a liability because the one might impact the other. She noted that the liability could be affected by subsequent events and they had analysed these as those that were outside the control of the entity and those where the entity could take action. The first case was not a great problem, for example, an insurance company had a stand ready liability to meet a claim. However, in the second case where liability depended on entity's future actions, did it have a liability before it took those actions? The conceptual framework didn't give a clear answer and the standards appeared to be inconsistent.

Paragraph 7 included a series of examples. These were real life problems that had been submitted to the Interpretations Committee. Paragraph 8 was the staff's discussion of three possible approaches. The staff considered approach 1 and approach 3 to be extremes and approach 2 to be a compromise. Approach 1 was discussed in paragraph 9. The obligation must be unconditional. The Interpretations Committee when looking at interpretations in relation to IAS 37 had taken this approach but IAS 19 and IFRS 2 did not. They required liabilities to be recognised before vesting conditions were satisfied. Approach 3 was discussed in paragraph 15 and would focus on past events, disregarding future events. She thought that applying approach 3 would lead to recognition of liabilities in all the examples that were set out in paragraph 7.

Approach 2 set out in paragraph 11 was the middle ground. It identified types of obligations which were recognised. She said she was not entirely happy that they had nailed approach 2. The questions for the Board were on page 13 and these were which approaches should they include in the discussion paper and did they have any preliminary views?

Mr. Hoogervorst asked if she had thought more about the definition of approach 2 since the paper had been distributed. Ms. Brown replied that some people had suggested that it should take into account some element of exchange. Someone else suggested that you should have received and consumed the benefits in order for there to be a liability.

Philippe Danjou said that if you looked only at the liability, you were only looking at one element. A liability was part of a transaction. He thought that approach 3 was guilty of only looking at one part.

Mr. Zhang said he thought it was useful to use examples in the discussion paper and possibly the exposure draft but they should not be in the final conceptual framework. That would lock the Board too much into a position. Ms. Brown said she agreed. It would pre-judge other projects. They were used here in an attempt to focus this discussion.

Mr. Zhang said he preferred the middle ground but he noted that in paper 3F on measurement the staff had raised the issue of whether it was correct to focus exclusively on the statement of financial position or the statement of comprehensive income and not look outside of that, but it seemed to him that they were only looking at this the liability from a balance sheet point of view. There was a discussion in that paper of going concern in relation to management and he thought this should be part of the discussion of elements. Peter Clark commented that it could be in more than one chapter.

Mr. Mackintosh observed that the element of exchange might solve some problems but it would not be present in all liabilities, for example, in litigation. Ms. Brown said there was no future event in litigation. Ms. McConnell in relation to approach 3 said she was curious as to whether staff had given any thought to symmetry with the asset definition. Did the counter-party have to have an asset? Ms. Brown said she thought for every liability there should be an asset. The liability was about a transfer of resources and those resources had to go to somebody.

Mr. Engström said he had difficulty in understanding approach 2. What about an employment contract? If you had a three month notice period, should you not have a liability for that? Ms. Brown said she thought that was not a liability that was being accumulated. She thought that salary failed to meet condition (a). The employee hadn’t yet provided services. Mr. Engström asked about pensions. Should you not provide for future salary increases? Peter Clark said it was difficult to see how unvested benefits would get in. Mr. Mackintosh noted they had debated future salary increases in relation to the UK standard and decided that it was a measurement question.

Pat Finnegan said he thought staff had done an outstanding job. He had been surprised at the balance, content and cogency of the arguments. As regards to this analysis he thought they should expose approaches 2 and 3. He thought that approach 1 was off the table. It didn’t provide sufficiently useful information. Some people thought the question was whether you want a probabilistic model or a deterministic model. If you wanted the most useful information, some people thought using settled transactions such as the incurred losses was not useful and were moving away from that. He thought that the question of approach 2 or approach 3 was more to do with what exactly you wanted to measure, that a contract had been signed and would have consequences or did you take the view that, until goods were delivered, you didn’t care.

Mr. Ochi said that he thought symmetry was important but there were two types. The one was the symmetry with the counter-party but he thought there was also a second one, which was symmetry with an asset generated in your company. You were making business. You were creating assets and through that were incurring the liability. In approach 2 you were trying to make the symmetry with the asset that you were creating but approach 3 destroyed that symmetry.

Mary Tokar said she thought she was a tentative approach 2 person. For her this was not looking at the balance sheet and the income statement but thinking about debits and credits when the entity was acquiring or consuming something. She thought that example 1 in paragraph 7 didn’t make sense under approach 1. Should you not recognise because the entity might pay zero? She would knock out approach 1 completely. As regards approach 3 she thought that raised a going concern issue and how that fed into consideration of whether there was a liability or not. She was somewhere in approach 2 but she thought it should address going concern. When she thought of the case of the levies was the entity getting some sort of permission to operate? Was there a debit as well as a credit? She thought they should make it clear they had considered all three approaches but were not recommending approach 1. Mr. Gomes said he shared her view. They needed to address going concern and he was leaning towards approach 2.

Steve Cooper commented that this area was one of three or four key problems in the project. He felt it was too early for him to express a view. The staff needed to develop the area further. He thought all three approaches should be in the paper. He noted that in relation to approach 2 emissions trading didn't turn out to be a liability. He would like to know how that played out. He also thought that approach 2 had a flavour of probability in it. The expression theoretical possibility implied that. He wondered if they were trying to define liability or making another kind of probability. Approach 3 seemed more principle-based. He asked if approach 3 meant that unvested pensions became a liability. Ms. Brown said they did because the liability was accumulating. She added that to her mind what was critical in approach 2 was the exchange, not the future events. The obligation had started to accumulate.

Mr. Hoogervorst asked if approach 3 appealed to Mr. Cooper more. Mr. Cooper replied that he was trying not to think about what appealed to him. It was the emissions problem that interested him. Ms. Brown speculated that if they articulated approach 2 more in the way Ms. Tokar had suggested, they might end up with emissions coming into it. Mr. Cooper raised the question of economic compulsion. Ms. Brown said that could cover all sorts of things and impacted on things like future events and constructive obligations. The staff had been trying to resolve those first before coming on to economic compulsion.

Peter Clark commented that paragraph 11(b) was not intended to be probability. The starting block in approach 1 was that there had to be an obligation but there was a class of things where, although the entity was almost certainly going to pay something, it could take some action to avoid doing so but in some cases the entity was unlikely to take that action.

Mr. Finnegan said that an emissions regime constrained the company to do something that it wouldn't otherwise do. It was going to have to reduce emissions or buy additional rights. He did not understand why emissions did not fall into approach 2. Ms. Brown said they fell at paragraph 11(a) not 11(b) because they had not yet started to emit. Mr. Finnegan said if you focused on the existence of an asset and an obligation, you got a different answer. Mr. Mackintosh wondered whether the asset might be a conditional asset.

Mr. Kalavacherla said for him the focus was the first part, whether the obligation had happened or not. Ms. Brown suggested the obligating event was the receipt of something. Mr. Kalavacherla said he was not completely in favour of either approach 2 or approach 3.

Wayne Upton (IASB director) said he favoured approach 1. The reason was that the definition was as important for what it excluded as for what it included. Ms. Brown's focus was not on the obligating event but he thought if you included it, you'd get the same breakdown as Ms. Brown. He said that looking at approach 3 he wondered if that opened the door to restructuring provisions. The IASB had always said a Board decision was not an obligating event. Ms. Brown said that it didn't force people to deliver on more onerous terms than would have been required otherwise.

Mr. Suh commented that these were important issues for the Board but he wondered how the market saw things. Ms. Brown asked if he meant did they price unrecognised liabilities into the share price. She thought that in the case of banks that did happen. Mr. Suh said he thought they were depending too much on a theoretical approach. He thought they should check what was important in practice.

Mr. Hoogervorst commented that he thought they'd had a good discussion but it was only possible because of the examples. He thought it would be extremely hard to come up with a precise definition in this area. He thought they had to have the examples.

Ms. Tokar said she thought approach 1 might work if you were thinking of the problem as how to apply IAS 37 but if you were thinking of something which applied across all standards, she thought you would move away from approach 1. She thought the examples were useful but not sure that they should be in the conceptual framework. They seemed to be more standards level. She also observed that using the emissions trading example wasn't necessarily a good guide because it may be you had to think of the whole programme in accounting for emissions trading and not in terms of assets and liabilities.

She thought did think they needed to include the going concern and also about economic compulsion should never be considered or should always be considered. Mr. Upton added that on employee contracts he thought the employer was already in a stand ready obligation once they issued the contract. He thought that maybe took that question off the table.

Mr. Mackintosh said he understood Mr. Ochi's external symmetry but he was not sure about the internal symmetry. He thought that could lead to smoothing and matching. He also put in another plea for using the term economic benefits rather than cash flows to make the wording compatible with public sector.

Mr. Hoogervorst summed up that there did not seem to be many takers for approach 1. He asked the staff if they had been able to observe a clear leaning. Ms. Brown said some Board members had suggested they should address going concern and economic compulsion. Did they have any observations as to what should be considered?

Ms. McConnell said she wanted to clarify her position. She was one of possibly few members who would stay with the current definition of liability. She thought that approach 2 was a modification of approach 1 and was an attempt to rationalise what the Board had done in its standards but she did not think they had articulated it in an appropriate way and she thought if they couldn't do that, they should stay with approach 1 and leave the Board to override that in issuing individual standards, citing cost/benefit or useful information and so on. Mr. Hoogervorst agreed that they should try to come up with a better solution but if not they could use this legalistic approach and indicate it could be too confining in individual situations.

Mr. Finnegan commented that he was not sure that everybody in the financial markets had the same concept of going concern. It could be interpreted as any entity before it actually had the intention or the necessity to liquidate but someone else could say it was someone who didn't have enough money to pay the next 12 months' bills. He thought they should clarify what they meant.