

The International Accounting Standards Board met in London on 22 and 23 January 2003, when it discussed:

- Arrangements for the public roundtable discussions on IAS 32 and IAS 39
- Business combinations (phase II)
- Convergence of accounting standards
- Employee benefits
- First-time application of IFRSs
- Insurance contracts.

Arrangements for the public roundtable discussions on IAS 32 and IAS 39

At its December 2002 meeting the Board agreed to hold a series of roundtable discussions on the proposed amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*. The Board also agreed that, to provide some structure to the discussions, a set of questions would be sent to participants well in advance of the roundtables. These questions were not limiting and would not prevent participants from raising other issues or Board members from asking other questions.

The Board discussed proposed questions, developed by the Staff, on the main issues raised in the comment letters. The invitation to the roundtables asked participants to indicate their relative priorities for these issues. They are:

- The distinction between debt and equity, including derivatives on own shares
- Derecognition of financial assets
- Derivatives and hedge accounting
- Impairment of financial assets
- Other issues.

The Board agreed with the overall approach suggested by the Staff. It suggested some improvements and made other comments. The Board also asked that an introduction be added to the questions :

- to state that the Board appreciates that some participants will not want to address all of the questions and that participants are free to address as many or as few questions as they wish.
- to set out the background to the development of IAS 32 and 39 and the reasons for their main requirements.

The Staff will revise the draft roundtable questions in light of the Board's discussions. Once revised, the questions will be sent to participants and posted on the IASB Website, in late January or early February.

Business combinations (phase II)

Accounting for non-monetary consideration exchanged for shares issued by the acquiree in a business combination

The IASB considered the accounting for a business combination in which consideration in the form of a business or other non-monetary asset is given in exchange for shares issued by another entity, which thereby becomes the first entity's subsidiary.

The Board agreed that such a business combination should be accounted for at fair value, ie measured by direct measurement of the fair value of the business over which the acquirer obtains control (the acquiree) or based on the fair value of the consideration paid, whichever is more clearly evident of the fair value of the assets acquired and liabilities assumed. However, the business or non-monetary assets given by the acquirer should not be viewed as part of the assets acquired and liabilities assumed from the acquiree. This is because the acquirer controls the business or non-monetary asset both before and after the business combination. Therefore, the full amount of any profit or loss arising on the transfer to the acquiree of the business or non-monetary asset should be eliminated in the consolidated financial statements.

The Board noted that this decision should not be viewed as pre-empting its future consideration of 'fresh start' accounting issues as part of this project.

Working principle—clarifications

The Board considered whether the working principle applying to the project, which is a joint project with the FASB, should be amended. The working principle, which was initially agreed to by the Board at its meeting in November 2001, had been developed in the context of a business combination in which the acquirer obtains control of a 100 per cent ownership interest in the acquiree.

However, the Boards have now also considered matters relating to business combinations involving minority interests, and some of its decisions raise questions about the clarity of the working principle and the extent to which parts of their respective lower level guidance should be extended.

The Board tentatively agreed to clarify the working principle and its related guidance to ensure that it applies to business combinations in which the acquirer obtains control of less than a 100 per cent ownership interest in the acquiree.

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Convergence

Post-employment benefits

The Board discussed the presentation of various items of income and expense arising from post-employment benefits in the context of the presentation of comprehensive income being developed in its project on the income statement (reporting performance).

Presentation of expected return on assets

The Board confirmed its decision that in the income statement interest income (ie expected return) should not be presented separately from other changes in value of plan assets.

Presentation of settlements and curtailments

The Board agreed that in the income statement gains and losses arising from settlements and curtailments would be presented as business activity remeasurements.

Presentation of the impact of the asset ceiling

The Board agreed that any income or expense resulting from the application of the asset ceiling test should be presented in the income statement as a financial asset remeasurement. In the footnotes, it should be disclosed separately from the other components of the defined benefit cost.

Recognition of unvested benefits

The Board reconsidered its earlier decision that unvested benefits should be recognised on a straight-line basis over the vesting period and reverted to the current requirements of IAS 19 *Employee Benefits*, ie that benefits should be recognised according to the benefit formula (except when service in later years leads to a materially higher level of benefit than in earlier years, in which case straight-line allocation is required). The Board noted that a consequence of this is that some increases in unvested benefits would be allocated to past periods, giving rise to a past service cost. The Board confirmed its previous decision that any such past service cost should be recognised immediately, rather than over the vesting period (as currently required by IAS 19).

Disclosure of the classes of assets held by the defined benefit plan

The Board agreed that disclosure should be required of the broad asset classes held by the pension plan. The classes would be determined using the principle in IAS 32 *Financial Instruments: Disclosure and Presentation* paragraph 46, ie that financial instruments should be grouped into classes that are appropriate to the nature of the information disclosed, taking into account matters such as the characteristics of the instruments. The Staff was instructed to consult the Board on practical problems that might arise from this requirement.

Position of the defined benefit asset/liability in the balance sheet

The Board agreed that the defined benefit asset/liability should be prominently and separately presented in the balance sheet because of its significance and sensitivity to changes in market prices and estimations.

Availability to group companies of the exemption from defined benefit accounting for participants in multi-employer plans

The Board agreed that the exemption for participants in multi-employer plans from defined benefit accounting should be extended to the individual entities within a group.

Sensitivity information

The Board instructed the Staff to develop a paper on which defined benefit assumptions may be sufficiently significant to warrant the disclosure of sensitivity information. Any practical problems arising from such a requirement should also be considered.

Assets held for disposal

The Board discussed issues relating to the possible convergence of its existing Standards with the requirements for long-lived assets held for sale under FAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*. The Board tentatively agreed:

- to introduce into IFRSs, for non-current assets that an entity intends to dispose of, the classification 'held for sale' using criteria based on those contained in FAS 144.
- to introduce into IFRSs the notion of a disposal group, being a group of assets to be disposed of together, by sale or otherwise, in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.
- to specify that non-current assets or disposal groups that are classified as held for sale should be measured at the lower of (i) carrying amount and (ii) fair value less cost to sell.
- to specify that a non-current asset classified as held for sale, or included within a disposal group that is classified as held for sale, should not be depreciated.
- to specify that a non-current asset that ceases to be classified as held for sale should be measured at the lower of (i) the carrying amount had the asset not been classified as held for sale and (ii) its recoverable amount.
- to specify that a non-current asset classified as held for sale, and the assets and liabilities included within a disposal group classified as held for sale, should be disclosed on the face of the balance sheet.

The Board agreed that these changes should be introduced by drafting a new IFRS addressing the accounting for held for sale assets, disposal groups and the reporting of discontinued operations¹.

The Board also agreed that it should make a consequential amendment to IAS 36 *Impairment of Assets* to amend the definition of "recoverable amount" to "the higher of an asset's ~~net selling price~~ fair value less cost to sell and its value in use", with 'fair value' having the same meaning as in the Glossary.

Government grants

The Board considered IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and agreed that it should be withdrawn and replaced with a new IFRS.

The Board discussed various alternatives for its replacement, focusing on the recognition issues posed by entities receiving

¹ In November 2002 the Board agreed to replace IAS 35 *Discontinuing Operations* and converge as closely as possible with the requirements for discontinuing operations in FAS 144.

conditional government grants, and instructed the Staff to consider further the differences between the approach for the recognition of conditional contributions under US GAAP (FAS 116 *Accounting for Contributions Received and Contributions Made*) and Australian GAAP (UIG-11 *Accounting for Contributions of, or Contributions for the Acquisition of, Non-Current Assets*). The Board tentatively agreed that, should it be unable to resolve on a timely basis the differing views for the treatment of conditional grants, it would use its existing guidance for government grants contained in IAS 41 *Agriculture* as the basis of a new IFRS, pending completion of its project on Revenue Recognition.

First-time application of IFRSs

The Board continued its discussion of the comment letters received on ED 1 *First-time application of International Financial Reporting Standards* and agreed changes in the following areas:

- derecognition of financial instruments
- compound financial instruments
- date of transition to IFRSs for some entities
- revalued amount as deemed cost.

Derecognition of financial assets and financial liabilities

An entity may have derecognised financial assets or financial liabilities under its previous generally accepted accounting principles that do not qualify for derecognition under IAS 39. ED 1 proposed that a first-time adopter should recognise those assets and liabilities in its opening IFRS balance sheet. This proposal was consistent with the June 2002 exposure draft of improvements to IAS 39, but not with the current version of IAS 39, which prohibits restatement of securitisation, transfer or other derecognition transactions entered into before the beginning of the financial year in which IAS 39 was initially applied.

The Board agreed that it would be premature to require a treatment different from the current version of IAS 39, given that the proposed improvements to IAS 39 have not been finalised. Accordingly, the Board agreed that the IFRS on first-time application should require the same treatment as the current version of IAS 39 for transactions before the effective date of the current version of IAS 39. In other words, if a first-time adopter derecognised financial assets or financial liabilities under its previous GAAP in a financial year beginning before 1 January 2001, it should not recognise those assets and liabilities under IFRSs (unless they qualify for recognition as a result of a later transaction or event).

When it finalises the improvements to IAS 39, the Board will consider whether this exemption for past derecognition transactions should be amended or deleted.

The Board also:

- agreed to make a consequential amendment to IAS 39 to clarify that an entity is required to apply IAS 39 to all derivatives created or other interests retained after a transaction that was derecognised under previous GAAP.
- confirmed that there would be no exemptions for special purpose entities (SPEs) that existed before the date of transition to IFRSs. ED 1 did not propose any exemptions for SPEs and the Board noted that SIC – 12 *Consolidation - Special Purpose Entities* contains no exemption for pre-existing SPEs.

Compound financial instruments

IAS 32 *Financial Instruments: Disclosure and Presentation* requires an entity to split a compound financial instrument at inception into liability and equity components. Even if the liability component were no longer outstanding, retrospective application of IAS 32 would require separate identification of two components of equity. The first component is a reduction of retained earnings and represents the cumulative interest accreted on the liability component. The other component represents the equity component. The Board agreed that a first-time adopter need not identify these two components separately if the liability component is no longer outstanding at the date of transition to IFRSs.

Date of transition to IFRSs for some entities

Paragraph 5 of ED 1 proposed an exemption intended to ease the transition to IFRSs for an entity whose parent first adopted IFRSs at an earlier date. The Board agreed to reword this exemption as follows: “If, in the previous period, a first-time adopter was included in consolidated financial statements containing an explicit and unreserved statement of compliance with IFRSs, the first-time adopter may elect to use measurements in its own opening IFRS balance sheet that reflect the consolidated group’s date of transition to IFRSs.” For example, suppose that parent P presents its first consolidated IFRS financial statements in 2005 with 1 January 2004 as the date of transition to IFRSs, but its foreign subsidiary S does not present its own first IFRS financial statements until 2007. In its opening IFRS balance sheet at 1 January 2006, S may elect to use measurements reflecting a date of transition to IFRSs of 1 January 2004.

The main changes from the exemption proposed in ED 1 are:

- the revised wording makes the exemption optional.
- use of the revised exemption does not require approval by the minority shareholders.
- the revised exemption would be available not only to subsidiaries, but also to first-time adopters that are associates, joint ventures or the parent itself (in its individual financial statements, if it prepares them).

Revalued amount as deemed cost

Using its previous GAAP, an entity may have revalued an item of property, plant and equipment at or before the date of transition to IFRSs by applying, for example, a general or specific price index to a cost that is broadly comparable to cost determined under IFRSs, or have revalued the items to an amount that is broadly comparable to fair value determined under IFRSs. ED 1 proposed that an entity could elect to treat such revalued amounts as deemed cost under IFRSs at the date of the revaluation.

The Board agreed that a first-time adopter could also use this election for an intangible asset if the asset both:

- meets the recognition criteria in IAS 38 *Intangible Assets*, including the requirement that cost can be measured reliably
- qualifies under IAS 38 for revaluation (which requires reference to an active market).

Other changes

The Board also agreed that:

- a first-time adopter should be permitted to reset to zero the ‘corridor’ for actuarial gains or losses on defined benefit plans in cases of undue cost and effort. (ED 1 proposed that this resetting would be compulsory.)
- An entity should be permitted (not required, as proposed in ED 1) to use event-driven fair value measurement of some

or all assets and liabilities (eg in a past privatisation) as deemed cost.

Next steps

In February, the Board will discuss how first-time adopters should apply hedge accounting.

The Board expects to publish the final IFRS in the second quarter of 2003.

Insurance contracts

The Board discussed both phases I and II of the project on insurance contracts.

Phase I

The objective of phase I is to put some components of the project in place by 2005, without delaying phase II. The Board also wishes to avoid requiring changes in phase I that might be reversed in phase II. The Board does not intend to develop in phase I specific recognition and measurement requirements for most aspects of insurance contracts.

The Board discussed two features (participation features and cancellation or renewal rights held by the policyholder) that are found in many insurance contracts and also in some contracts within the scope of IFRSs that address financial instruments (ie IAS 32 and IAS 39). The Board discussed whether it should require entities to adopt a particular method of accounting for these features in financial instruments during phase I, given that it will review their treatment within insurance contracts during phase II.

The Board directed the Staff to develop proposals to grant a temporary exemption from IAS 32 and IAS 39 during phase I to a participation feature that comprises a contractual right held by the investor to receive additional payments or other benefits:

- that are based on (i) the performance of a specified pool of contracts or a specified type of contract or (ii) the profit or loss of the company, fund or other entity that issues the performance-linked contract; and
- whose amount or timing is wholly or partly at the discretion of the issuer.

In all other respects, financial instruments containing such features would remain subject to IAS 32 and IAS 39. The Board will review the Staff's proposals at a future meeting before deciding whether to grant a temporary exemption.

The Board also discussed whether it should grant a temporary exemption for some contractual rights held by investors to cancel or renew contracts. The Board directed the Staff to research this topic further for discussion at a future meeting.

Phase II

The Board discussed phase II of the project on insurance contracts and tentatively agreed to develop a model that has the following features:

- The model is an asset-and-liability model requiring an entity to identify and measure directly individual assets and liabilities arising from insurance contracts, rather than creating deferrals of inflows and outflows.
- Assets and liabilities arising from insurance contracts should be measured at their fair value, with the following two caveats:
 - (a) Recognising the lack of market transactions, an entity may use entity-specific assumptions and information when market-based information is not available without undue cost and effort.
 - (b) In the absence of market evidence to the contrary, the estimated fair value of an insurance liability shall not be

less, but may be more, than the entity would charge to accept new contracts with identical terms and remaining term from new policyholders. It follows that a policy issuer would not recognise a net gain at inception of an insurance contract, unless such market evidence is available.

- As implied by the definition of fair value:
 - (a) An undiscounted measure is inconsistent with fair value.
 - (b) Expectations about the performance of assets should not be incorporated into the measurement of an insurance contract, directly or indirectly (unless the amounts payable to a policyholder depend on the performance of specific assets).
 - (c) The measurement of fair value should include an adjustment for the premium that marketplace participants would demand for risks and mark-up in addition to the expected cash flows.
 - (d) Fair value measurement of an insurance contract should reflect the credit characteristics of that contract, including the effect of policyholder protections and insurance provided by governmental bodies or other guarantors.
- The measurement of contractual rights and obligations associated with the closed book of insurance contracts should include future premiums specified in the contracts (and claims, benefits, expenses, and other additional cash flows resulting from those premiums) if, and only if:
 - (a) policyholders hold uncancellable continuation or renewal rights that significantly constrain the policy issuer's ability to reprice the contract to rates that would apply for new policyholders who have similar characteristics to the existing policyholder and
 - (b) those rights will lapse if the policyholders stop paying premiums.
- Acquisition costs should be recognised as an expense when incurred.

The Board will consider two more questions at a future meeting:

- Should the measurement model unbundle the individual elements of an insurance contract and measure them individually?
- How should a policy issuer measure its liability to holders of participating contracts?

Over the last 14 months, the Board has been discussing the Draft Statement of Principles (DSOP) developed by a former IASC Steering Committee. The model differs from the proposals in the DSOP in two areas:

- the use of a fair value measurement objective rather than entity-specific value
- the criteria used to determine whether measurement should reflect future premiums and related cash flows.

Board members noted that the shift from entity-specific measurement (the approach advocated in the DSOP) to fair value is not as significant as it might seem. The approach to entity-specific measurement described in the DSOP is almost indistinguishable from level 3 of the fair value hierarchy that the Board has adopted in its projects on Business Combinations. The Board concluded that IFRSs should not use different terms that describe the same measurement.

The Board directed the Staff to develop the model more fully by starting work on a draft exposure draft, so that the Board and Staff can see conclusions in context and identify second-level issues that need Board deliberation. The Staff will develop a

timetable for this work. The Board directed the Staff to pay particular attention to:

- the reliability of fair value measurements (particularly the adjustment that marketplace participants would demand for risk and mark up)
- the criteria for determining whether measurement should reflect future premiums and related cash flows.

Meeting dates: 2003

The IASB will meet in public session on the following dates. Meetings take place in London, UK, unless otherwise noted.

19 – 21 February[†]

Week of 10 March – public roundtables on IAS 32 and IAS 39[§]

19 – 25 March

24 April – 2 May[‡]

21 – 23 May

16 – 20 June[†], Rome, Italy

23 – 25 July

17 – 23 September[‡]

22 – 24 October, Toronto, Canada

17 – 21 November[†]

17 – 19 December

[§] Meeting venues to be confirmed – see www.iasb.org.uk

[†] Includes a meeting with the Standards Advisory Council

[‡] Includes a meeting with partner national standard-setters