BOARD DECISIONS ON INTERNATIONAL ACCOUNTING STANDARDS

IASB UPDATE

May 2003

The International Accounting Standards Board met in London on 20 – 23 May 2003, when it discussed:

- Business combinations (phase II)
- Convergence issues
- Financial instruments
- Financial risk disclosures
- IFRIC issues
- Leases
- Reporting performance
- Revenue recognition
- Share-based payment

# Business combinations (phase II)

## Minority interests: disclosures

The Board considered whether, as a result of decisions in the joint project relating to minority interests, additional disclosures should be required of an entity with one or more subsidiaries that are less than wholly-owned.

The Board agreed that amounts attributable to the controlling interest should be disclosed for income from continuing operations and discontinued operations. The Board also agreed to require disclosure of the reconciliation of minority interests reported in equity that would include the balance of minority interests at the beginning of the period and at the balance sheet date and the movements for the period, including profit or loss for the period attributable to minority interests and each item of income and expense recognised directly in equity attributable to minority interests.

## Minority interests: comment period, effective date and transition provisions

The Board considered the comment period, proposed effective date and transitional provisions for the forthcoming Exposure Draft resulting from decisions on minority interests (which will be drafted as an amendment to IAS 27 *Consolidated and Separate Financial Statements*).

The Board agreed to adopt a 90-day comment period for the minority interests Exposure Draft to give constituents sufficient time to analyse the Exposure Draft and develop comments. Because the issues are very interrelated, the business combinations and the minority interests Exposure Drafts will be issued at the same time, with the same comment deadline.

The Board also agreed that the minority interests and business combinations final Standards should become effective at the same time. The Board agreed to propose that these Standards be effective for annual reporting periods beginning on or after 1 January 2006, with early application encouraged. The requirements of both the business combinations and the minority interests Standards should be adopted at the same time. Therefore, an entity should not be permitted to adopt the requirements of one Standard early and not the other.

The Board agreed to require retroactive adoption for all minority interest decisions provided that the requirements may be applied prospectively if retroactive adoption is not practicable. The Board also agreed to make consequential amendments to transitional provisions in IFRS 1 *First-time Adoption of IFRSs*.

# Convergence issues

## IAS 33 *Earnings per Share*

The Board discussed briefly the status of the project on Improvements to IAS 33 *Earnings per Share*. In February 2003, the Board tentatively decided to withdraw several of the proposed amendments to IAS 33 (see February 2003 *IASB Update*) and directed the staff to work with the US Financial Accounting Standards Board to determine whether the FASB would (i) consider adding earnings per share to the scope of the short-term convergence project and (ii) consider amending FAS 128 *Earnings per Share* to converge with IAS 33. The Board was informed that the FASB is still considering the issues. The Board decided to proceed with finalising IAS 33 as part of the Improvements project.

## IAS 11 *Construction Contracts*

The Board agreed not to consider in the short-term convergence project differences between IAS 11 and US GAAP in revenue recognition under construction contracts. All revenue recognition issues will be considered in the IASB/FASB joint project on that topic. The Board agreed to ask the IFRIC to consider the guidance on combining and segmenting contracts in AICPA Statement of Position 81-1 *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* with a view to:

(a) adding guidance in IAS 11 on the criteria for combining contracts

(b) clarifying that the conditions in IAS 11 for combining contracts are such that it will be very rare for a group of contracts with more than one customer to meet the conditions

(c) considering whether the additional criteria for segmenting contracts in US GAAP are consistent with the requirements in IAS 11.

## Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

The Board considered a draft of proposed amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The draft reflected tentative decisions that the Board had previously made in its (i) short-term convergence project (changes to the application guidance for restructuring provisions) and (ii) business combinations (phase II) project (changes to the definition of contingent assets and contingent liabilities).

### *Contingent assets and liabilities*

The Board had previously agreed that the definitions of contingent assets and contingent liabilities should be amended to clarify that only present rights and present obligations can give rise to assets and liabilities.

The Board confirmed its decision that contingent liabilities should be recognised if (a) it is a probable that an outflow of resources will be required to settle the contingent liability and (b) a reliable estimate can be made of the amount of the obligation.

The Board considered the distinction between provisions and contingent liabilities and concluded that since provisions are liabilities of uncertain timing or amount, they should be recognised when the entity incurs a present obligation unless a reliable estimate cannot be

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## Convergence issues *(continued)*

made of the amount of obligation. It therefore agreed that the current probability recognition criterion for provisions (paragraph 14(b)) should be withdrawn.

The Board agreed that as contingent assets are present rights, the requirements in IAS 37 prohibiting their recognition should be amended to conform to the *Framework*. It therefore agreed that a contingent asset should be recognised if it is probable that future economic benefits will flow to the entity. The Board also agreed to amend the recognition criterion for reimbursements (IAS 37 paragraph 53) from "virtually certain" to "probable".

*Application guidance for restructuring provisions*

The Board had previously agreed that it could not converge with FAS 146 *Accounting for Costs Associated with Exit or Disposal Activities* in the accounting for costs that will continue to be incurred under a contract for its remaining term without economic benefit to the entity. The Board had noted that such a contract would be an onerous contract under IAS 37 and therefore that a provision could be recognised at an earlier point than when the entity ceased to use the right conveyed by the contract as specified by FAS 146.

The Board noted, however, that the existing requirements for onerous contracts, in certain circumstances, conflicted with its decision that management intent does not, by itself, give rise to liabilities. The Board therefore concluded that when a contract becomes onerous as a result of the entity's own actions, the resulting provision should not be recognised until that action has occurred. For example, in the case of an operating lease on a property that will become vacant as a result of a restructuring, the provision for the unavoidable lease commitment should be recognised when the entity vacates the property.

The Board noted that this would converge with FAS 146. It also agreed to converge with FAS 146 and specify that if the contract is an operating lease, the provision for the unavoidable lease commitment should be reduced by the sublease rentals that could reasonably be obtained for the property.

*Measurement*

The Board had previously agreed not to converge with the fair value measurement objective for liabilities as set out in recent FASB Statements (FAS 143 *Accounting for Asset Retirement Obligations* and FAS 146) at this time. However, it agreed to make the following limited amendments to the existing measurement requirements of the Standard for clarification and to remove inconsistencies:

- provisions should be measured at the amount an entity would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time
- using an expected value estimation technique would generally be consistent with this principle, whilst measuring a provision at a single point estimate of the most likely outcome would not
- provisions should be remeasured at each reporting date using a current discount rate.

*Disposal of non-current assets and reporting of discontinued operations*

The Board considered issues arising from the first pre-ballot draft of an ED *Disposal of Non-current Assets and Reporting of Discontinued Operations*. The Board agreed to proceed with the classification 'held for sale' rather than a classification of 'retired from active use'.

The Board agreed that the scope of the draft IFRS should be the same as that of FAS 144 *Accounting for the Impairment or Disposal of Long Lived Assets* except for the following items that are excluded from FAS 144 but would be included in the draft IFRS:

- intangible assets not being amortised
- long-term customer relationships
- associates and joint ventures
- assets in certain specialised industries specified in FAS 144
- deferred policy acquisition costs
- unproved oil and gas properties that are being accounted for using the successful-efforts method of accounting.

The Board considered whether the proposed definition of discontinued operations should be amended so as to exclude operations that an entity routinely buys and sells, such as investment properties in an investment property company. The Board agreed that a question on this issue should be asked in the exposure draft.

The Board agreed that the phrase 'highly probable' should be used in the draft IFRS as a substitute for the phrase 'probable' in FAS 144, with an explanation that both phrases implied the same level of probability, ie a level higher than 'more likely than not'.

Finally the Board agreed that the proposals should apply to newly acquired assets, in particular that assets acquired in a business combination that meet the criteria for classification as held for sale on initial recognition should be measured at fair value less cost to sell, on initial recognition, rather than at fair value.

## Post-employment benefits

The Board agreed to require the disclosure of the effect of a one percentage point increase and a one percentage point decrease in the key drivers of the cost of post-employment benefits on (i) the surplus or deficit in the plan and (ii) the aggregate of the current period service cost and interest cost. Possible key drivers include:

(a) the assumed real medical cost trend rates

(b) the real discount rate (taking into account the impact of such changes in real interest rates on the value of any fixed interest bonds held as plan assets but assuming no change in the value of other plan assets)

(c) the expected real rate of salary increases and

(d) the inflation assumption. The change would be assumed to affect only those assumptions that specifically include an inflation assumption, for example the discount rate and salary and benefit increases. Hence, for example, it would be assumed not to affect the value of quoted equities.

The Board also agreed to require disclosure of the broad classes of assets held by the plan.

# Financial instruments

## Improvements to IAS 32 *Financial Instruments: Disclosure and Presentation*

*Economic compulsion*

In April 2003 the Board tentatively agreed to proceed with the proposal in the exposure draft to remove the example of economic compulsion in IAS 32 paragraph 22. It also agreed to retain the notion that an instrument that does not establish a contractual obligation explicitly may establish it indirectly through its terms and conditions.

At this meeting, the Board considered the concern expressed in the comment letters that a financial instrument that contains a non-financial obligation which must be settled if the entity fails to make payments to the holder would not meet the definition of a financial liability and would be classified as equity. The Board tentatively agreed to clarify in IAS 32 that such an instrument should be classified as a financial liability.

However, the Board noted that this clarification would not address the situation in which, if an entity fails to make payments to the holder of an instrument, it triggers settlement of an obligation to deliver shares. The Board considered the example of a preferred share where, in the event that a payment was not made, the issuer is required to issue a very large, fixed number of shares to the holder. The Board tentatively agreed that such an instrument should be classified as a financial liability and agreed to add wording to IAS 32 to clarify this conclusion.

 

## Improvements to IAS 39 *Financial Instruments: Recognition and Measurement*

### *Derecognition of financial assets*

The Board considered the conditions that must be met before a transfer of a financial asset qualifies for derecognition under IAS 39. The Board tentatively agreed not to proceed with the approach proposed in the Exposure Draft of proposed improvements to IAS 39, but to revert to the concepts in the original IAS 39 (eg control and substantially all the risks of ownership). More specifically, the Board tentatively agreed to clarify how and in what order those concepts should be applied, as follows:

(a) An entity should first evaluate what asset has been transferred (ie an entire asset, a proportion of an asset or specifically identified cash flows from an asset).

(b) The entity should then evaluate its exposure to the likely variation in all the cash flows from the transferred asset before and after the transfer (ie a risks and rewards test). The exposure would be evaluated on a present value basis using market interest rates. If the entity has retained substantially all the exposure (eg for a repurchase transaction or a sale of a loan portfolio with a guarantee of all the risk), the asset would continue to be recognised in its entirety. If the entity has transferred substantially all the exposure (eg a sale with an option to repurchase the asset at its fair value), the asset would be derecognised in its entirety and any remaining components recognised.

(c) If the entity has neither retained nor transferred substantially all of the exposure, the entity should evaluate whether it has retained control of the transferred asset. Control would be evaluated based on whether the transferee has the practical ability to sell the asset. If the transferor has retained control (eg for a sale of a non-traded asset with an option to repurchase it at a fixed price), the asset would continue to be recognised to the extent the transferor may reacquire its previous contractual rights (the transferor's retained exposure). If the transferor has lost control, the transferred asset would be derecognised.

The Board also tentatively agreed the following:

(a) To consider further the interaction between the approach for derecognition agreed by the Board and the guidance proposed on pass-through arrangements.

(b) If derecognition of a transferred available-for-sale financial asset is precluded because of a retained call option, the asset would continue to be measured at fair value and the liability would be adjusted for changes in the fair value below the option exercise price.

(c) To proceed with the guidance proposed in the Exposure Draft about servicing assets and servicing liabilities.

(d) To proceed with the guidance proposed in the Exposure Draft about computation of gains and losses on a sale.

(e) To proceed with the guidance proposed in the Exposure Draft about accounting for non-cash collateral.

### *Pass-through arrangements*

The Board considered whether certain contractual arrangements under which an entity collects cash flows on a financial asset and passes them through to another entity (a 'pass-through arrangement') should qualify as a transfer of the financial asset. The Board tentatively agreed to proceed with issuing guidance on the conditions that must be met for pass-through accounting to apply as proposed in the Exposure Draft. The Board also tentatively agreed that contractual arrangements to pass through cash flows where the entity passes on a fully proportional share of the collections of all or specifically identified cash flows qualify for pass-through accounting. The Board tentatively agreed to consider further the interaction with SIC-12 *Consolidation – Special Purpose Entities* for contractual arrangements where the entity does not have a fully proportional share (ie arrangements with disproportionate risk sharing such as an arrangement where the entity retains a subordinated residual interest).

### *Hedge accounting for a macro hedge of interest rate risk*

The Board considered whether IAS 39 should be amended so as to permit an entity to use fair value hedge accounting for a macro hedge of interest rate risk. In particular, the Board considered, in outline, an approach that is being developed in meetings between representatives of the Board and representatives of the Fédération Bancaire de l'Union Européenne (FBE). The Board was not asked to make a decision on the approach at this meeting, in the light of the fact that some important details have not yet been finalised. It expressed its support for continuing to develop the approach.

### *Basis adjustments for forecast transactions that will result in the recognition of a non-financial asset or a non-financial liability*

The Board considered whether to prohibit basis adjustments for hedges of forecast transactions that will result in the recognition of a non-financial asset or a non-financial liability, or to permit a choice to use basis adjustments for such transactions. The Board agreed to permit a choice.

### *Hedges of portions of non-financial assets and liabilities for risk other than foreign currency risk*

The Board considered whether IAS 39 should permit entities to designate as the hedged item an ingredient or component of a non-financial asset or non-financial liability other than foreign currency risk. The Board tentatively agreed that IAS 39 should not be amended to permit such designation. It also agreed that IAS 39 should clarify how non-financial items may be hedged in their entirety when the item the entity is hedging is not the standard item underlying contracts traded in the market.

The Board also considered whether IAS 39 should allow entities to designate the interest rate risk component of loan servicing rights as the hedged risk. (IAS 39 currently treats loan servicing rights as non-financial assets and non-financial liabilities.) The Board tentatively agreed that IAS 39 should not be amended to permit such designation.

### *Internal contracts*

The Board considered whether internal transactions (ie transactions that are internal to the reporting entity or group, eg internal derivative contracts and internal payables and receivables) can be designated as hedging instruments or hedged items under IAS 39. The Board tentatively agreed:

(a) to confirm that it is a fundamental principle of consolidation that any accounting effect of internal contracts is eliminated on consolidation.

(b) not to explore an amendment to IAS 39 to permit internal derivative contracts to be designated as hedging instruments in hedges of forecast foreign currency transactions consistent with US GAAP.

(c) to clarify that intragroup payables and receivables in certain cases qualify as hedged items in hedges of foreign currency risk because of the functional currency concept in accounting for changes in foreign exchange rates under IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

(d) to clarify that IAS 39 does not preclude hedge accounting for intra-group transactions or transactions between segments in the separate reporting for those companies or segments.

### *Loan impairment*

The Board considered the accounting for impairment in a group of financial assets. The Board tentatively agreed:

(a) to confirm the proposal in the Exposure Draft that a financial asset measured at amortised cost that has been individually evaluated for impairment and found not to be impaired should be included in a group of similar financial assets that are collectively evaluated for impairment.

(b) to clarify that impairment losses should be recognised only when they are incurred, ie that IAS 39 uses an incurred loss model to recognise loan impairment.

(c) to clarify that an impairment loss is recognised only if there is objective evidence of impairment resulting from an event occurring after the initial recognition or previous assessment of a loan, ie credit quality has deteriorated from the previously assessed position. In addition, the event must be based on current observable data and have a reliably measurable impact on the recoverable amount of the loan.

(d) to provide guidance about how to group financial assets when assessing impairment on a group basis (in particular that loans that have been evaluated individually should not be assessed on the same basis as others that have not been evaluated individually).

*Re-exposure issues*

The Board was asked for its preliminary assessment of whether the decisions it had made on IAS 39 warranted re-exposure. This assessment was to assist in allocating staff resources to ensure any new Exposure Draft could be issued in time to enable the Standard to be finalised early in 2004. The Board was reminded that it would have the opportunity to consider the issue of re-exposure at a later Board meeting, once all the key decisions have been made.

The Board tentatively agreed *not* to re-expose the following issues:

- reversals of impairment on available-for-sale financial assets
- basis adjustment for hedges of forecast non-financial asset and liability transactions
- hedges of portions of non-financial assets and non-financial liabilities for risk other than foreign currency risk (the Board has tentatively agreed no change should be made to IAS 39 or the ED on this issue)
- loan impairment
- internal contracts
- derecognition of financial assets.

# Financial risk disclosures

The Board last discussed this project in December 2002. At that time, the Board supported the Financial Activities Advisory Committee (FAAC) beginning to draft an exposure draft and application guidance for financial risk disclosures and other amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 1 *Presentation of Financial Statements*. The intention is that when the exposure draft and application guidance for financial risk disclosures and other amendments to IAS 32 and IAS 1 are issued, IAS 30 *Disclosure in the Financial Statements of Banks and Similar Financial Institutions* will be withdrawn and certain parts of IAS 32 and IAS 1 superseded or amended.

The purpose of the discussion at the May Board meeting was to review with the Board the FAAC's activities from December 2002 and to seek the Board's views on certain matters.

*Capital disclosures*

The Board reconsidered whether entity-specific capital requirements imposed by external parties (eg a regulator) should be required to be disclosed. It tentatively agreed that IAS 1 should include a capital disclosure requirement that focuses on:

(a) how an entity manages its capital resources and how capital requirements imposed by external parties (eg a regulator) are incorporated into the entity's management of its capital resources; and

(b) when an entity does not comply with external capital requirements during the period, the fact that it does not comply, the consequences and intended rectification of such non-compliance.

The Board recommended that in drafting the amendment to IAS 1, an illustration of circumstances where an entity would be required to disclose non- compliance should be included.

*Issuance and Effective Date*

The Board considered the proposed project timetable—a final publication in 2005 and an effective date of 1 January 2007. The Board tentatively agreed that with its current workload and its goal of issuing by 31 March 2004 all Standards that will be effective from 1 January 2005, it would not be possible to issue a final financial risk disclosures Standard, and related amendments to IAS 32 and IAS 1, any sooner than 2005. However, it tentatively agreed to issue these documents early in 2005, to enable entities that wish to adopt them earlier than required (eg in 2005) to do so.

The Board also noted that in finalising its amendments to IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement*, it will consider if any consequential amendments are required to IAS 30 for requirements that are redundant and/or inconsistent.

### Amending the scope of IAS 14 *Segment Reporting*

In February 2003 the Board, as part its insurance (phase I) project, discussed disclosure principles and requirements for insurers. In particular, the Board discussed segment information required by IAS 14 and expressed a preference for extending the scope of IAS 14 to include all insurers and deposit-taking institutions. The Board also tentatively agreed to address this question in the project on financial risk disclosures. The Board reconsidered this decision and tentatively agreed that an amendment to the scope of IAS 14 would be better considered in the longer-term convergence project, which includes IAS 14.

# IFRIC issues

### Changes in decommissioning and similar liabilities

The Board reviewed the following approaches that the IFRIC had considered for accounting for a change in estimated cash flows or a change in the discount rate of decommissioning and similar liabilities:

(a) capitalising the part of the change in the estimated cash flows or discount rate that relates to future periods, and recognising the part of the change that relates to current and prior periods in current period profit or loss.

(b) the same as the approach in (a), except all of the effect of a change in the discount rate would be recognised in current period profit or loss.

(c) recognising the effect of all changes in either the cash flows or the discount rate in current period profit or loss.

The IFRIC had agreed that it preferred approach (a) because it is consistent with the IFRIC's view that a change in the estimated cash flows represents a change in the cost of the related asset. It also treats all changes (whether to the cash flows or the discount rate) in the same way, which the IFRIC agreed is important given that some factors, eg inflation, can affect both the cash flows and the discount rate.

The Board tentatively agreed that it did not object to the IFRIC proceeding with an exposure draft of an Interpretation based on its preferred approach. In addition, the Board made the following recommendations concerning the drafting of the draft Interpretation:

(a) The draft Interpretation's basis for conclusion should clearly set out why the IFRIC decided not to adopt the US GAAP approach for accounting for changes in estimated cash flows (capitalising all changes in estimated cash flows and depreciating them prospectively).

(b) The draft Interpretation should specify clearly that it addresses only changes in estimated costs that fall within the scope of IAS 16 *Property, Plant and Equipment* and not for example costs that are within the scope of IAS 2 *Inventory*.

### Accounting for reimbursements

The Board considered the issue of accounting for reimbursement rights that had arisen from the IFRIC's discussions on how to account for the right to receive reimbursements from decommissioning funds.

When an entity makes a contribution to a decommissioning fund, it becomes entitled to receive reimbursement from the fund in the future. However, the timing and amount of the reimbursement are not fixed.

The Board noted that the IFRIC had identified two forms of rights to reimbursement:

(a) contractual rights to receive reimbursement in the form of cash. These would meet the definition of a financial asset and fall within the scope of IAS 39.

(b) rights to reimbursement other than the contractual right to receive cash, such as a contractual right to receive reimbursement in the form of services. These would not meet the definition of a financial asset and would therefore be accounted for under IAS 37. IAS 37 is silent on the measurement of reimbursements (though it contains some guidance on recognition).

The Board noted the IFRIC's concern that the two forms of rights to reimbursement would be accounted for differently. The Board additionally noted that the IFRIC believes that the right to reimbursement should be accounted for at fair value with changes in fair value reported in the income statement.

The Board considered the IFRIC's proposal to exclude all rights to reimbursement to settle a provision from the scope of IAS 39, so that the IFRIC would be free to provide guidance on the measurement of all reimbursement rights. The Board was concerned that such a scope exclusion would be too wide and might encompass other, unintended circumstances, such as a reimbursement made to an entity under a guarantee.

The Board discussed an alternative approach, which would be to keep contractual rights to receive reimbursement in cash within the scope of IAS 39, but to change IAS 39 so that such assets would be accounted for at fair value with changes in fair value recognised in the income statement. The Board did not conclude which would be the better approach. However, the Board agreed with the overall intention of the IFRIC.

The Board directed the staff to consider both options and return to a subsequent meeting to discuss them.

## Leases

The Board discussed a leasing project plan prepared in conjunction with staff of the UK Accounting Standards Board.

Leasing is an active research project. The paper presented outlined a proposal for commencing the Board's leasing project. The paper addressed the following:

(a) a summary of the fundamental issues to be addressed in developing a lease accounting model;

(b) required interaction with other IASB projects; and

(c) an indicative project timetable.

The Board tentatively agreed, subject to receiving advice from the Standards Advisory Council, that the IASB should undertake a leasing project with the objective of developing a single method of accounting for leases that is consistent with IASB's *Framework*. The single method would not rely on a distinction between operating and finance leases.

The Board tentatively agreed with the proposal that the project should first address leases of property, plant and equipment. The application of the principles derived for leases of tangible assets would be addressed subsequently for intangible assets.

The Board tentatively agreed that the project would include consideration of the accounting for:

- both lessees and lessors
- contingent rentals
- guaranteed residual values
- lease options
- sale and leasebacks.

It was noted that a number of projects being undertaken by the Board are relevant to the leasing project and, in particular, that the leasing project should take account of work being undertaken by the Board in relation to revenue recognition, measurement, derecognition and consolidation. Further consideration is to be given to the appropriate order in which issues should be addressed given these interactions.

## Reporting performance

The staff reviewed with the Board its findings from the pilot test (UK) stage of the pre-ED field visits. The session was for information purposes and no decisions were made.

Participating constituents had raised the following matters:

(a) The definition and presentation of 'financial' and 'financing' do not accommodate the reporting of an entity's treasury activities. Also, there are concerns that reporting the write-down of accounts receivable within 'financial' would be misleading.

(b) Pilot test participants challenged, on both conceptual and measurement-related grounds, the presentation of write-downs of accounts receivable and inventory impairments as remeasurements.

(c) The proposed voluntary early adoption in 2005 could be problematic. It was noted that this is not just a technical, feasibility issue, but also an issue of alignment with internal reporting and management responsibility, as well as being an issue affecting investor communications. The possibility was raised of requiring pro-forma reporting on the 'old' (current IAS 1) format.

(d) The Board also discussed briefly the allocation of income tax, the reporting of an earnings subtotal and several issues specific to banking activities (including net interest income, operating profit, loan loss provisions and trading profits).

## Revenue recognition

The Board discussed the following four ways of looking at revenues as the basis for developing a definition of revenues:

- the Gross Inflows View;
- the Liability Extinguishment View;
- the Broad Performance View; and
- the Value Added View.

These views focus on the amount of revenues, rather than when it is recognised.

The *Gross Inflows View* defines revenues in terms of the consideration received from the reporting entity's customers over which the reporting entity obtains control.

The *Liability Extinguishment View* defines revenues as decreases in the reporting entity's liabilities to customers resulting from the extinguishment of performance obligations for which it is primarily liable at law. Those obligations are extinguished by providing goods and services to customers, either directly by the reporting entity itself or indirectly by having third parties provide them on its behalf.

The *Broad Performance View* defines revenues as increases in the reporting entity's assets (including inflows of assets or enhancements of assets) or decreases in its liabilities resulting from activities that are integral to the provision of products (goods and services) by the entity itself that are ultimately destined for customers.

The *Value Added View* defines revenues as the excess of the value of the reporting entity's outputs in the form of goods and services that it creates over the costs of its inputs in the form of materials and services that it purchases from other entities.

The Board tentatively agreed that:

(a) the definition of revenues should *not* be based on the Gross Inflows View or the Value Added View described above

(b) the definition of revenues and the recognition criteria for revenues should be based on the same view of revenues

(c) the working definition of revenues should focus on activities related to the provision of goods and services to customers

(d) the definition of revenues should be complemented by disclosures about various aspects of the reporting entity's performance.

The Board asked the staff to draft a list of increases in economic benefits that would be included in revenues under the Gross Inflows View that should be excluded from revenues, and reasons for the proposed exclusions. In developing this list, the staff was asked to address the following issues:

- consistency between the treatments of goods provided and services provided
- whether the reporting entity controls the goods it sells
- performance obligations
- custodial obligations
- assets received in an agency capacity
- the treatment of sales taxes
- the treatment of borrowings and other sources of finance.

## Share-based payment

### Measurement date

ED 2 *Share-based Payment* proposed that, if a share-based payment transaction is measured by reference to the fair value of equity instruments granted, that fair value should be measured at grant date. In April 2003, the Board reviewed an analysis of comments received, which noted that the majority of respondents who addressed the issue agreed with the proposal in ED 2. Of those respondents who disagreed with measurement at grant date, the most commonly cited preferred alternative measurement date was exercise date, followed by vesting date.

The Board considered this issue in the context of employee share-based payment transactions only. In this context, the Board tentatively agreed that the proposal to measure at grant date the fair value of the equity instruments granted should be retained in the final IFRS. Whether the same measurement date should be applied in the context of share-based payment transactions with parties other than employees will be considered at a later Board meeting.

### Accounting for employee services received

ED 2 also proposed the use of a units of service method to account for employee services received as consideration for equity instruments of the entity. Under this method, a deemed fair value per estimated unit of service is determined, based on the fair value of the equity instruments granted. This amount is then applied to actual services received during the vesting period. This method differs from the method applied in the US standard FAS 123 *Accounting for Stock-Based Compensation*:

(a) under FAS 123, the estimate of the fair value of an equity instrument at grant date does not consider the possibility of forfeiture due to failure to satisfy the vesting conditions, whereas ED 2 proposed that the possibility of forfeiture should be taken into account in estimating fair value.

(b) under FAS 123, the transaction is ultimately measured at the number of vested equity instruments multiplied by the fair value of those equity instruments at grant date. Hence, any amounts recognised for employee services received during the vesting period will be subsequently reversed if the equity instruments granted are forfeited. Under the proposals in ED 2, amounts recognised for employee services received are not subsequently reversed, even if the equity instruments granted are forfeited.

Respondents were asked for their views on the use of the units of service method to account for services received (Question 9), whether there should be any subsequent adjustment if options or shares are forfeited because of failure to satisfy the vesting conditions (Question 10), and whether vesting conditions should be incorporated into the grant date valuation of the equity instruments granted (Question 13). Respondents were also asked for their comments on the units of service method proposed in ED 2 compared with the approach in FAS 123 (Question 24(b)). The Board reviewed an analysis of comments received in response to these questions.

### Units of service method

Overall, just over half of respondents who addressed this issue disagreed with the proposal in ED 2. Disagreement was highest amongst preparers of financial statements (companies and their representative bodies) and share scheme consultants. Concerns were expressed that the calculation is complex and subjective, or that the amount of information required to apply the method would be burdensome. Some respondents disagreed with the proposed method for these reasons, even though they noted that the units of service method is conceptually superior to the FAS 123 approach. However, some respondents disagreed with the units of service method in principle.

### Subsequent adjustment for actual forfeitures

Respondents who addressed this issue were evenly divided between those who agreed and those who disagreed with the proposal that there should be no subsequent adjustment to total equity, in the event that the equity instruments granted did not vest or, in the case of options, the options were not exercised. Support for the proposal was highest among standard-setters, and accountancy bodies and firms. The majority of companies disagreed with the proposal.

### Including the effect of vesting conditions in the grant date valuation

ED 2 proposed that vesting conditions should be taken into account when estimating at grant date the fair value of options or shares granted. Overall, the majority of respondents who addressed this issue supported the proposal in ED 2. However, some respondents expressed concerns that adjusting the grant date valuation for the effect of vesting conditions could be subjective. Some respondents requested additional guidance to facilitate practical application. Some respondents agreed with the proposal in ED 2 but believed that the issue was of less importance if the amount recognised is adjusted for the outcome of vesting conditions, in a manner similar to the FAS 123 method.

### Comparison of units of service method with the method in FAS 123

Respondents who addressed this issue had mixed views. Some supported the units of service method and some supported the FAS 123 method. Some supported a combination of the two.

### Board discussion and tentative decisions

The Board discussed the units of service method, compared with the FAS 123 method, in the light of comments received. The Board tentatively agreed that the IFRS should adopt the FAS 123 method rather than retaining the units of service method, for practical reasons.

However, the Board also tentatively agreed that entities should not be permitted the choice contained in FAS 123 when calculating the amount to recognise in each accounting period, and should instead be required to estimate at grant date the number of options/shares expected to vest and revise that estimate, if necessary, if subsequent information indicates that actual forfeitures will differ from initial estimates. The Board also tentatively agreed that market price-based performance conditions should be incorporated into the option pricing model applied at grant date (which is consistent with the requirements of FAS 123).

### Timing of recognition of employee services received

ED 2 proposed that, if an employee is required to complete a specified period of service before the equity instruments vest, the entity should recognise the services received over the vesting period.

The majority of respondents who expressed a view on this issue agreed with the proposal. This includes respondents who expressed some concerns, but stated that they do not see a better solution and therefore agreed with the proposal in ED 2. However, some respondents thought that the presumption that the services are received during the vesting period should be rebuttable. Some respondents argued that a grant of equity instruments to employees does not always relate to future services; it may relate to services already received, or for a combination of past and future services. Some respondents commented that more guidance was needed when the vesting conditions included both service and performance conditions, including situations where there is a variable vesting date.

The Board tentatively agreed to retain the proposal in ED 2 in the final IFRS. The Board will consider at a later date whether additional guidance should be provided on determining the vesting period in particular circumstances.

## Meeting dates: 2003

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

16—20 June†, Rome, Italy

23—25 July

17—19 September; 22 and 23 September‡

22—24 October, Toronto, Canada

17—21 November†

17—19 December

† Includes a meeting with the Standards Advisory Council

‡ Includes meetings with partner and other national standard-setters