

The International Accounting Standards Board met in London on 16 and 17 November, when it discussed:

- Business combinations
- Consolidation (including SPEs)
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- IAS 39 *Financial Instruments: Recognition and Measurement*
- IFRIC matters
- Joint ventures
- Leases
- Post-employment benefits

In addition, the IASB met the Standards Advisory Council on 18 and 19 November 2004. A report of this meeting will be included in a forthcoming issue of *IASB Insight*.

## Business Combinations (phase II)

### Common drafting issues

The Board discussed issues that were identified in developing the joint FASB-IASB Business Combinations exposure draft. Most of the issues relate to differences between IFRS 3 *Business Combinations* and SFAS 141 *Business Combinations* that were not part of the boards' deliberations in this joint project. At this meeting, the Board was asked to state its preferences regarding acceptable alternatives for resolving these differences in the interest of reaching convergence. The FASB will be asked a similar question when it discusses these issues at its meeting on 24 November. When two or more alternatives were acceptable to the Board, the Board indicated its preferences, which will be communicated to the FASB, but it did not reach conclusive decisions. Rather, in those cases, the final decisions will depend on the alternatives the FASB also finds acceptable and the decisions it reaches at its meeting.

### Definition of a business combination

The Board, in IFRS 3, and the FASB, in phase II of the project, developed different definitions of a business

combination. Originally, the boards did not plan to reconsider jointly the definition of a business combination. However, now that the IASB and the FASB have decided to develop a joint Business Combinations exposure draft, the boards agreed that reaching a single definition is of primary importance.

The Board stated that its preference is to explore with the FASB developing a new definition of a business combination that more effectively describes the economic event, if this can be accomplished expeditiously. However, if the FASB decides against developing a new definition, the Board decided that it would be willing to converge with the FASB's definition.

### Identifying the acquirer

The guidance in IFRS 3 for identifying the acquirer differs from that in SFAS 141. The IASB's guidance is based on the definition and guidance on control that is included in IAS 27 *Consolidated and Separate Financial Statements*. The FASB's guidance does not rely on control because there is no guidance similar to the IASB's on control in US GAAP.

The Board decided that it would prefer to explore jointly converged guidance for identifying the acquirer that will be included in the joint exposure draft. The Board also decided that any guidance for control included in IFRS 3 should be moved to IAS 27 to the extent that it is not covered in IAS 27 at present. The IASB's version of the joint exposure draft should merely refer to the guidance on control in IAS 27.

### Reliable measurement

IFRS 3 requires that all assets acquired and liabilities assumed in a business combination must be reliably measurable in order to be recognised. SFAS 141 does not have a similar requirement. The Board considered whether the reliability of measurement criteria should be retained in the revised IFRS 3.

The Board concluded that the joint exposure draft should retain the IFRS 3 requirement that intangible assets acquired in a business combination must

be reliably measurable to be recognised separately from goodwill. The Board also concluded that the joint exposure draft should include guidance similar to that in IAS 38 *Intangible Assets*, which provides guidance when an intangible asset cannot be measured reliably. The Board also decided not to include such a requirement for other assets and liabilities, as it is already an overriding criterion for recognition in the *Framework*.

### Incorporation of EITF guidance into the joint exposure draft

As part of its codification efforts, the FASB tentatively decided to incorporate the guidance in two existing EITF Issues as part of its implementation guidance on the joint exposure draft: EITF 95-8 *Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in Purchase Business Combination* and EITF 04-1 *Accounting for Preexisting Relationships between the Parties to a Business Combination*. The FASB believes that the guidance in those issues is consistent with the decisions reached by the IASB and the FASB in phase II.

The Board indicated its willingness to consider that guidance with the objective of incorporating it in the exposure draft provided it concurs that the guidance is consistent with the decisions reached in phase II.

(Continued...)

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## **Business combinations (phase II) (continued)**

### *Accounting for adjustments to provisional values as a result of completing the initial accounting for a business combination*

IFRS 3 requires the acquirer to recognise any adjustments to provisional values as a result of completing the initial accounting as if the initial accounting had been completed at the acquisition date. However, practice in the US is that such adjustments are generally accounted for prospectively.

The Board decided to retain the requirement in IFRS 3 for completing the initial accounting. The FASB will discuss this issue at its next meeting and will discuss whether to converge with the Board's decisions.

### *Limited retrospective application*

The Board decided that the joint exposure draft should not permit the limited retrospective application option that IFRS 3 allowed in specified circumstances. The Board concluded that those circumstances would not be applicable upon adoption of the revised IFRS 3 and, thus, that provision is no longer necessary.

### *Terminology*

The IASB decided to adopt the term 'non-controlling interest' to replace 'minority interest' because it believes non-controlling interest is more accurate. An entity can hold a minority ownership interest but can have control through other means. Therefore, non-controlling interest is more consistent with the concept of control in IAS 27.

## **Business Combinations—Transitional provisions for business combinations involving two or more mutual entities or by contract alone**

The Board considered transitional provisions for business combinations involving two or more mutual entities or by contract alone without the obtaining of an ownership interest.

The Board decided that transitional provisions for these business combinations should be prospective as for other business combinations, and should incorporate the transitional provisions currently in IFRS 3. The Board noted that the transitional provisions currently in IFRS 3 take into consideration (and properly reflect) that entities may have used a number of alternatives in accounting for such past combinations.

## **Consolidation**

### **Progress on the Consolidation project**

The Board is nearing the end of its deliberations on the concept of control as it would apply generally (ie for entities other than special purpose entities (SPEs)). In November 2004, the Board considered whether, while embarking on its deliberations of how the principles developed in this project should apply to SPEs, it should publish (possibly as soon as mid-2005) an exposure draft of proposed amendments to IAS 27

*Consolidated and Separate Financial Statements*. The purpose of that exposure draft would be to incorporate into IAS 27, sooner rather than later, the extensive material and guidance the Board has so far developed on the concept of control as it would apply generally.

The Board concluded that this material would strengthen IAS 27. It therefore decided to proceed with such an exposure

draft, but not before it explores the likelihood that the control model developed in this project would be able to be adapted and applied to SPEs.

### **Fund managers with dual roles**

The Board had previously considered how the control definition might be applied if a fiduciary such as a fund manager has power over another entity (the investee) by virtue of a dual role in relation to that investee, ie:

- as a fund manager acting in a fiduciary capacity with power over a fund that has a holding in the investee, but the holding on its own does not give the fund manager power over the investee; and
- as a direct investor in the investee, but the holding on its own does not give the fund manager power over the investee.

The Board had previously concluded that there should be a rebuttable presumption that control is assessed in such circumstances by considering the fund manager's two positions together. At this meeting the Board considered possible criteria for when the presumption could be rebutted, but concluded that no workable criteria could be developed.

Therefore, the Board decided to amend its previous decision and require control to be assessed in such circumstances by considering the fund manager's two positions together. The Board also decided that the exposure draft should include a request for constituents to provide the Board with examples of circumstances in which it could be concluded that a fund manager that also has a direct investment does not control the investee.

### **Options over an asset versus options over an entity**

The Board had previously concluded that an investor's unexercised but currently exercisable holdings of options or convertible securities that give the holder the right to obtain other instruments that enable them to direct the investee's strategic financing and operating policies (potential voting rights) are relevant in assessing whether the investor controls the investee. For example, if Entity A has a 100 per cent ownership interest in Entity B, but Entity C holds currently exercisable options over all of the equity instruments in Entity B, then Entity C rather than Entity A would, in the absence of other factors, control Entity B.

A consequence of this tentative decision is what some might characterise as an anomaly in the timing of recognition of assets when options are held over an asset compared with when options are held over an entity that holds an asset. If the objective of consolidation and the notion of control being developed in this project are to provide a 'short cut' to identifying the underlying assets controlled by an entity, this anomaly might be regarded as resulting in the inappropriate recognition of assets. In other words, if potential voting rights are considered in assessing control, the resulting asset recognition criteria might be inconsistent with the recognition of holdings of similar rights directly over assets. At this meeting, the Board considered the apparent inconsistency.

The Board observed that there are two broad views on this issue. The first view is that at the heart of the apparent inconsistency in timing of recognition of assets is an apparently broader interpretation of benefits adopted for control of entities, compared with the traditional interpretation of benefits adopted for control of assets. The second view is that there is no

anomaly in the timing of recognition of assets because an option over an asset is different from an option over an entity that holds the asset.

The Board reached no conclusions on this issue, but asked the staff to develop some examples of how an entity that controls another entity by virtue of potential voting rights would account for:

- obtaining control of that other entity in accordance with the Board's tentative decisions in its Business Combinations phase II project; and
- the subsequent exercise of the options or convertible securities.

The Board also asked the staff, in developing these examples, to consider similar examples developed by the FASB as part of its Consolidation project.

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

The Board continued its consideration of the first draft of the exposure draft of amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The Board confirmed that the main amendments should be limited to those required:

- to converge with the requirements of SFAS 146 *Accounting for Costs Associated with Exit or Disposal Activities* for recognising costs associated with a restructuring; and
- to reflect the changes to the definitions and analysis of contingent liabilities (and assets) required by phase II of the Business Combinations project.

(Details of these amendments can be found in the project summary on the IASB Website.)

The Board also confirmed that it would publish the amendments as amendments to IAS 37 rather than as a new IFRS.

## **IAS 39 Financial Instruments: Recognition and Measurement—Transition and Initial Recognition of Financial Assets and Financial Liabilities**

The Board discussed comments received on the exposure draft of Proposed Amendments to IAS 39 *Financial Instruments: Recognition and Measurement—Transition and Initial Recognition of Financial Assets and Financial Liabilities* published in July 2004.

The last sentence of IAS 39 paragraph AG76 restricts recognition of 'day 1' gains and losses on the initial recognition of financial instruments. The exposure draft proposed that entities should be allowed to apply these requirements either retrospectively (as at present required by IAS 39), or prospectively for transactions entered into after 25 October 2002. The Board noted respondents' concerns that 25 October 2002 was not a relevant date for entities other than SEC registrants and that for non-SEC registrants it did not help resolve the cost and practicability issues of applying paragraph AG76 to transactions occurring after 25 October 2002. In the light of these comments, the Board decided to add a third alternative to the two in the exposure draft, namely that the

requirements could be applied prospectively for transactions entered into after 1 January 2004.

The exposure draft also proposed in paragraph AG76A that '...a gain or loss should be recognised after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price'. The Board decided to clarify in the Basis for Conclusions that, depending on the terms of the instrument, straight-line amortisation may be an appropriate method of recognising the difference between a transaction price (used as fair value in accordance with paragraph AG76) and a valuation made at the time of the transaction that was not based solely on data from observable markets. However, straight-line amortisation would not be appropriate in all circumstances.

The Board decided to finalise the proposals in the exposure draft, amended as set out above, without re-exposure.

## **IFRIC matters**

### **IFRIC Interpretation: *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds***

The Board discussed the proposed IFRIC Interpretation *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* arising from Draft Interpretation D4. A final draft of this Interpretation was approved by the IFRIC at its September meeting. The draft incorporates an amendment to IAS 39 *Financial Instruments: Recognition and Measurement*. In the light of this and the Board's desire to maintain a stable platform, the Board decided to propose to the IFRIC that it amend the effective date to 1 January 2006, with earlier application encouraged. Subject to this point and editorial amendments, the Board approved the publication of the Interpretation and the amendment to IAS 39, subject to ballot.

### **IFRIC Interpretation: *Members' Shares in Co-operative Entities and Similar Instruments***

The Board approved the publication of an IFRIC Interpretation *Members' Shares in Co-operative Entities and Similar Instruments* arising from Draft Interpretation D8, subject to ballot.

### **IAS 1 Requirements for Classification of Expenses by Nature or Function**

The Board discussed whether possible amendments of IAS 1 *Presentation of Financial Statements* regarding the presentation of expenses in income statements that the IFRIC is considering would be beyond the IFRIC's mandate. The purpose of such amendments would be to ensure the completeness of amounts included in functional classifications of expenses, and to prevent presentation of particular expenses below the results of operating activities when entities elect to present that sub-total.

The IASB decided it would support an Interpretation by the IFRIC based on the following Board thinking from the Basis for Conclusions for IAS 1:

'It would be misleading and would impair the comparability of financial statements if items of an operating nature were excluded from the results of operating activities ...' if disclosed and 'For example, it would be inappropriate to exclude items clearly related to operations (such as inventory write-downs and restructuring and relocation expenses) because they occur irregularly or infrequently or are unusual in amount.'

The Board also decided that amendments to IAS 1 specifying which expenses should be included in particular functional classifications should not be addressed outside its project on reporting comprehensive income.

## Joint ventures

The Board had previously decided that:

- the Australian Accounting Standards Board (AASB) should take responsibility for a long-term research project on accounting by venturers for interests in joint venture arrangements.
- The IASB should rapidly progress a short-term convergence project with the objective of removing from IAS 31 *Interests in Joint Ventures* the option of accounting for interests in joint venture entities using either the equity method or proportional consolidation.

At this meeting the Board considered an analysis of:

- the issues that would need to be addressed in the short-term project; and
- whether those issues could be resolved in a reasonable time.

The Board concluded that if it were to undertake the short-term project it would need to address the following issues:

- the nature of interests in jointly controlled entities, including:
  - the substantive differences between an interest in a jointly controlled entity and other forms of joint arrangements, such as undivided interests in assets or groups of assets.
  - possible inconsistencies between the substance and form of jointly controlled entities, and the effect (if any) of legal form on the substance of such arrangements.
- which of the two methods (ie equity method or proportional consolidation) more faithfully represents the economic substance of interests in jointly controlled entities.
- any differences between the notions of a jointly controlled entity in IFRSs and a corporate joint venture in US GAAP.

The Board noted that the research project team is well under way with its consideration of the substantive nature of interests in jointly controlled entities. The Board asked the staff to contact the research project team to determine when the team would be able to report its findings to the IASB.

The Board also asked the staff to assess the availability of staff resources to undertake the short-term project.

## Leases

The Board considered a paper, prepared by staff of the UK Accounting Standards Board, that explored how assets and liabilities recognised under a conceptual model for contractual rights and obligations might be accounted for using the measurement bases for similar assets and liabilities set out in existing IFRSs. The Board discussed lessees' contractual rights of use of property, plant and equipment in the context of IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*; lessee's variable lease obligations in the context of IAS 37 or IAS 39 *Financial Instruments: Recognition and Measurement*; lessor's rights to receive variable lease payments in the context of IAS 38 or IAS 39; renewal and purchase options; and lessors' residual interests.

The Board noted that this approach gave rise to several issues relating to the mixed measurement bases in existing IFRSs and decided that the project should not be constrained by them. The Board noted the lack of guidance in existing standards on accounting for options over non-financial assets. It also noted that application of the cost model (as defined in IAS 16), should result in the cost of the right of use arising from the exercise of a renewal or purchase option including the option's fair value at the exercise date.

The Board noted that further efforts were needed to resolve differences between the ASB and the IASB in respect of contingent rentals. It also asked the staff to summarise the tentative decisions in the project to date and those still outstanding.

## Short-term convergence: Post-employment benefits

The Board considered the following three issues arising from comments by Board members and others, including the IFRIC fatal flaw review, on a pre-ballot draft of amendments to IAS 19 *Employee Benefits*:

- the disclosure of cumulative actuarial gains and losses not recognised in profit or loss
- the requirements for group plans and
- the disclosure of the expected rate of return.

The Board decided that the disclosure of cumulative actuarial gains and losses not recognised in profit or loss should be of the amounts recognised in the statement of recognised income and expense. The amounts should not include any amounts recognised directly in retained earnings on a change in accounting policy.

The Board also decided that the requirements for group plans in the individual or separate financial statements of group entities should be redrafted to clarify that a group entity must obtain information about the plan as a whole measured in accordance with IAS 19 on the basis of assumptions applicable to the plan as a whole. If there is a contractual agreement or stated policy for charging the net defined benefit cost measured in this way, the group entity should recognise an allocation of the net defined benefit cost determined in accordance with the contractual agreement or stated policy. If there is no such agreement or policy, the group entity should recognise a cost equal to the contribution charged for the period. In both cases, disclosures about the plan as a whole would be required.

Lastly, the Board confirmed its previous decision not to require the expected rate of return for each major class of plan asset. However, it decided to expand the requirement for a narrative description of the basis for determining the overall expected rate of return to include discussion of the effect of the asset mix.

### Meeting dates: 2004

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

14–17 December

### 2005

18–21 January

10 and 11<sup>†</sup>; 14–18 February

14–18 March

18–22 April (joint with FASB)

16–20 May

20–24; 27 and 28<sup>†</sup> June

18–22 July

19–23 September

17–21 October (joint with FASB), Norwalk, Connecticut, USA

10 and 11<sup>†</sup>; 14–18 November

12–16 December

<sup>†</sup> Includes a meeting with the Standards Advisory Council