BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

April 2005

The International Accounting Standards Board met in London on the 19 April, when it discussed:

- IFRS 6 – proposed urgent amendment
- Extractive activities research project
- Fair value option
- Insurance contracts
- Financial guarantee contracts
- IFRIC activities
- Short term convergence – income taxes

The IASB also met with the Financial Accounting Standards Board in a joint meeting on the 21 and 22 April, where they discussed:

- Income taxes
- Performance reporting
- Financial instruments – the way forward
- Conceptual framework – objectives of financial reporting

The IASB also met with representatives of the liaison national standard setters. A report on this meeting will be provided in a forthcoming edition of IASB *Insight*, which will be available to subscribers on the IASB Website (www.iasb.org)

IFRS 6 – proposed urgent amendment

IFRS 1 *First-time Adoption of International Financial Reporting Standards* paragraph 36B currently provides, for an entity that both (a) adopts IFRSs for the first time before 1 January 2006 and (b) applies IFRS 6 *Exploration for and Evaluation of Mineral Resources* before that date, an exemption from the requirement to provide comparative disclosures for IFRS 6. The Board's intention was to provide a wider exemption—not only to exempt such entities from providing comparative disclosures, but also to exempt them from the recognition and measurement requirements of IFRS 6 for the comparative period. The Board's intentions in this respect are summarised in paragraphs BC63-BC65 of the Basis of Conclusions on IFRS 6.

It has come to the Board's attention that some constituents find confusing the wording of IFRS 1 paragraph 36B. As a result, these constituents may not have understood that a wider exemption from providing comparative information is available for these entities. To dispel any such confusion and bearing in mind that the amendment is relevant for entities applying IFRS 6 in 2005, the Board decided to amend IFRS 1 paragraph 36B as soon as possible to clarify that this exemption is wider than comparative disclosures. The Board hopes to issue the amendments no later than 30 June 2005.

Given the urgency of the matter, the Board has posted the proposed amendments as an Exposure Draft for comment on its Website (http://www.iasb.org/current/ed.asp). Comments should be submitted in writing so as to be received by Friday, 3 June 2005. Depending on the comments received, the Board hopes to consider and finalise the amendments at its meeting in June 2005.

Extractive activities research project

The Board held educational sessions for the extractive activities research project. The focus of these sessions was on minerals and oil and gas reserves and resources, including an overview of the estimation of reserves and resources and of some of the major reserve/resource reporting codes used in the industries. The sessions were led by a representative from the Australasian Joint Ore Reserves Committee (assisted by a representative from the Combined Reserves International Reporting Standards Committee) and a representative from the Society of Petroleum Engineers Oil and Gas Reserves Committee. No decisions were made. The materials for the presentations are in the observer notes for this meeting at http://www.iasb.org/meetings/0504.asp.

Another educational session is planned for an upcoming meeting to identify the various options available for defining reserves and resources for financial reporting purposes.

Fair value option

In April 2004, the Board published an Exposure Draft of proposed amendments to the IAS 39 *Financial Instruments: Recognition and Measurement* fair value option. In September, it discussed the comment letters received, when it noted that a large majority of respondents did not agree with the proposals in the Exposure Draft. It also noted that reverting to the unrestricted fair value option in IAS 39 (as revised in March 2004) would not address the concerns of regulators, which were the reasons for publishing the Exposure Draft. Therefore, the Board asked the staff to explore whether there was an alternative solution that could be acceptable to all parties – the Board, regulators and other constituents.

Over the last four months the Board has sought and discussed constituents' comments on a draft of a possible new approach. As part of this process, the Board held a series of round-table meetings in March with invited constituents to discuss the draft of a possible new approach. Participants in those meetings indicated their overall support for the possible new approach.

At this meeting, the Board decided to proceed to amend IAS 39 with regard to the fair value option.

Following initial discussions of possible transition requirements for the amendment in March, the Board discussed comments received on a staff paper on transition that had been posted on the IASB Website. The Board decided:

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Fair value option *(...continued)*

- The amendment will be effective for annual periods beginning on or after 1 January 2006, with earlier application encouraged.
- On first application of the amendment existing IFRS preparers and first-time adopters of IFRSs in 2005 may designate as at fair value through profit and loss any previously recognised financial assets or financial liabilities that qualify under the amendment, if the amendment is adopted in their annual period beginning before 1 January 2006. An existing user of IFRSs must also de-designate any financial assets and financial liabilities previously designated at fair value through profit or loss that do not meet the criteria of the amendment for such designation. For practical reasons, the Board also decided to allow such an entity a period of three months after the publication date of the amendment to complete the designations and de-designations. Such designations may also include financial assets and financial liabilities recognised between the start of the annual period and three months after the amendment is issued. The Board also decided that when financial assets or financial liabilities designated as at fair value through profit or loss in accordance with these transition provisions were previously designated as the hedged items in fair value hedge accounting relationships they should be de-designated from those relationships at the same time.
- Any existing IFRS preparer that adopts the amendment in its annual period beginning on or after 1 January 2006 should de-designate any financial asset or financial liability previously designated as at fair value through profit or loss only if it does not qualify for such designation in accordance with the amendment. Such an entity must not designate any previously recognised financial assets or financial liabilities as at fair value through profit or loss.
- On application of the amendment, all existing IFRS preparers (and first-time adopters in 2005 who restate comparative information for IAS 39) should restate their comparative financial statements using the new designations for the financial assets, financial liabilities, groups of financial assets, financial liabilities or both, designated as at fair value through profit or loss. Such entities, however, should restate their comparative financial statements only if the designated items would have met the fair value option criteria in the amendment at the beginning of the comparative period or, if acquired after the beginning of the comparative period, at the date of initial recognition.
- A first-time adopter of IFRSs in 2006 will be permitted to designate any financial asset or financial liability as at fair value through profit or loss that qualifies under the amendment at the date of transition to IFRSs. The Board also decided to allow such an entity a period of three months after the publication date of the amendment to complete the designations. In addition, any financial assets or financial liabilities designated as at fair value through profit or loss at the date of transition that were designated in hedge accounting relationships in the comparative period should be de-designated from those hedge accounting relationships at the same time they are designated as at fair value through profit or loss.

The Board asked the staff to prepare a final draft of the amendment for ballot. The amendment is expected to be issued in June.

Insurance contracts (phase II)

The Board held educational sessions on non-life insurance contracts, focusing on discounting and risk margins, as a follow-up to education sessions at the February meeting on the same topics. The sessions were led by Australian and Canadian members of the IASB's Insurance Working Group: Tony Coleman of Insurance Australia Group and Phil Arthur of Ernst & Young. The materials for the presentations are in the observer notes for this meeting at http://www.iasb.org/meetings/0504.asp

Next Steps

The staff expect to seek direction from the Board at the May meeting on the following aspects of non-life insurance accounting:

- the level of detail to be given on estimating cash flows.
- whether the measurement of non-life insurance claims liabilities should include discounting and risk margins.
- a review of four possible measurement approaches discussed in January with the Insurance Working Group. The staff will recommend that work over the next few months should, for non-life insurance, focus on one, or at most two, of those approaches; furthermore, if two approaches are pursued, one would be consistent with an approach being explored in the joint IASB/FASB project on revenue recognition.

In addition, the staff expect that the Board will begin educational sessions on life insurance soon, perhaps at the July meeting. The Insurance Working Group meets next on 26 and 27 July in London. That meeting is likely to concentrate on life insurance accounting topics.

Financial guarantee contracts and credit insurance

In July 2004, the Board published an Exposure Draft on financial guarantee contracts and credit insurance. The Exposure Draft defined a 'financial guarantee contract' as a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs if a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

The Exposure Draft proposed that the issuer of such a contract should measure it initially at fair value. Subsequently, the issuer would measure it at the higher of:

- the amount initially recognised less, when appropriate, cumulative amortisation determined in accordance with IAS 18 *Revenue*.
- an amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

In January, February and March, the Board discussed the comment letters received and considered various alternative ways of proceeding. At this meeting, the Board reached the following conclusions:

- If the issuer of a contract within the scope of the Exposure Draft had previously asserted explicitly that it regarded such contracts as insurance contracts and had used accounting applicable to insurance contracts, the issuer could elect to apply either the approach proposed in the Exposure Draft or IFRS 4 *Insurance Contracts*.

- In all other cases, the issuer should apply the approach proposed in the Exposure Draft.

The Board noted that it would be clear in the vast majority of cases whether an issuer had:

- asserted explicitly that it regarded such contracts as insurance contracts. Such assertions would typically be found throughout an issuer's communications with customers, regulators, contracts, business documentation and financial statements.
- used accounting applicable to insurance contracts. In many jurisdictions, insurance contracts are subject to accounting requirements that are clearly distinct from the requirements for other types of transaction, such as contracts issued by banks or commercial companies.

The Board confirmed that it had completed its discussion of this project and directed the staff to prepare the final text for written ballot. Publication is expected in July.

IFRIC activities

Mr Stevenson reported on the March/April meeting of the IFRIC and pointed out that Board clearance would be sought for draft Interpretation on two IFRS topics (Group and treasury share transactions and the scope of IFRS 2 *Share-based Payment*), as well as approval to issue a final Interpretation on waste electrical and electronic equipment. The Board would also be asked to check some editorial changes to the already approved Interpretation, IFRIC 6 *Applying the Restatement Approach under IAS 29* Financial Reporting in Hyperinflationary Economies.

Mr Stevenson also drew attention to the initial publishing of reasons for rejection of issues submitted to the IFRIC for interpretation. The publication of the reasons is a new part of the IFRIC procedures. The proposed wording for rejection is to be submitted publicly to an IFRIC meeting, stay on the table until the following meeting and then be considered by the IFRIC. This is to give constituents time to raise matters if they do not agree with the issue or suggested reasons. The reasons for rejection of issues will subsequently be posted to the Website as historical records of the IFRIC's decisions.

Short-term convergence - income taxes

The staff reported two FASB decisions to the Board:

- If income is taxed at different rates depending on whether that income is distributed to shareholders, the FASB decided that:
  (a) Deferred tax assets or liabilities should be measured based on the undistributed rate.
  (b) To the extent that there is an obligation to distribute a portion of that income, recognise an asset or liability based on the difference between the distributed and undistributed rate.
- In determining the point at which deferred tax assets and liabilities should be adjusted for the effect of a change in tax laws or rates, the FASB decided that:
  (a) For operations within US taxing jurisdictions: to retain the current approach in SFAS 109, which requires the effect of a change in tax laws or tax rates to be recognised in the period of enactment. Changes in tax law are substantively enacted in the US only after the President signs the bill into law.
  (b) For operations beyond US taxing jurisdictions: to require an approach that is consistent with IFRSs. The IASB approach requires deferred tax assets and liabilities to be measured on the basis of tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. The point in the legislative process when a tax change occurs depends on the characteristics of that process.

  The FASB asked the IASB to consider whether similar wording could be added to IAS 12, ie that operations (including subsidiaries) within US taxing jurisdictions that apply IFRSs should reflect changes in the US tax laws on tax rates when they are enacted.

The Board noted that these decisions converged with its decisions on these matters. The Board also agreed to note in the amended IAS 12 that for US taxing jurisdictions the point of substantive enactment is when tax laws are enacted, as the FASB requested. As a result, any entity reporting under either IFRSs or US GAAP would recognise changes in tax laws and rates:

- In the period of enactment for operations within US taxing jurisdictions
- In the period of enactment or substantive enactment for operations outside US taxing jurisdictions

The Board discussed its previous decision to include as application guidance with IAS 12 a table showing what is regarded as the point of substantive enactment in various jurisdictions. It decided not to include such a table, but instead to explain the principle underlying the point at which law becomes substantively enacted.

The Board then considered a paper on the allocation of taxes to components of comprehensive income and equity. The Board decided to include in IAS 12 the requirements on allocation of taxes within SFAS 109, to the extent that those requirements do not conflict with the existing requirements of IAS 12. To the extent that the requirements conflict, ie those relating to the allocation of changes in tax effects previously recognised outside continuing operations, the Board expressed an interest in retaining the IAS 12 approach of recognising the changes outside continuing operations in the component of comprehensive income or equity in which the tax effect was originally recognised. The Board noted that some FASB members, when discussing the paper the previous week, had expressed a similar interest but had been concerned by the potential difficulties involved. The Board asked the FASB staff member who had raised these concerns to provide examples of the difficulties so that they could be discussed at the joint IASB/FASB meeting later in the week.

Income taxes (joint meeting)

Despite interest by members of both boards in exploring the IAS 12 approach to allocating the effects of tax laws and rates, the boards agreed that such exploration would be time consuming and, given that allocations are inherently arbitrary, that a timely converged approach was the more important objective. Consequently, at the joint meeting, the IASB and the FASB decided:

- Not to change the intraperiod tax allocation requirements in paragraphs 35-38 and 273-276 of SFAS 109.
- To amend IAS 12 to adopt the intraperiod tax allocation requirements of SFAS 109. The requirement to allocate income taxes to items previously credited or charged to equity contained in paragraphs 57, 58, and 61-65 of IAS 12 would be amended and replaced with guidance similar to that in paragraphs 35-38 and 273-278 of SFAS 109.
- To reconsider existing intraperiod tax allocation guidance in Segment B of the Reporting Financial Performance project.

Performance reporting (joint meeting)

At their joint meeting, the FASB and IASB agreed on the path forward for the performance reporting project including the type and timing of future public discussion documents. The boards agreed that the goals associated with the project have such different characteristics that the work should continue to be performed in segments. A description of issues included within each segment can be found in the performance reporting project update on the IASB Website.

Segment A – convergence

Segment A focuses on convergence on the required financial statement requirements. The boards decided:

- That a full/complete set of financial statements includes:
  - (a) A statement that shows balances of assets, liabilities, and equity at the beginning of the period—referred to as a **Beginning of the Period Statement of Financial Position**.
  - (b) A statement that shows balances of assets, liabilities, and equity at the end of a period—referred to as the **End of the Period Statement of Financial Position**.
  - (c) A statement that shows the changes in assets and liabilities occurring during the period, other than those arising from transactions with owners in their capacity as owners. That statement would include the currently required subtotal net income/profit or loss in FASB/IASB standards—referred to as a **Statement of Earnings and Comprehensive Income**.
  - (d) A statement that shows the changes in assets and liabilities occurring during the period arising from transactions with owners in their capacity as owners—referred to as a **Statement of Changes in Equity**.
  - (e) A statement that shows inflows and outflows of cash occurring during the period—referred to as a **Statement of Cash Flows**.
- That each individual financial statement within the full set of financial statements would be shown with equal prominence.
- To require a single Statement of Earnings and Comprehensive Income that presents a total for non-owners' changes in financial position (comprehensive income) and a required subtotal for net income/profit or loss.
- To require comparative information consisting at a minimum of full sets of financial statements for two annual periods (the current and prior annual period). This would mean an entity would present three statements of financial position and two statements of earnings and comprehensive income, statements of changes in equity, and statements of cash flows.
- Not to provide guidance on the presentation of financial information beyond the required minimum (ie full sets of financial statements for two annual periods) that an entity might provide voluntarily.
- To exclude from the scope of this project issues that would address the content of information in the notes to financial statements (other than consequential amendments).
- To exclude from the scope of this project issues that would address the content of information in interim financial statements (other than consequential amendments). (IASB only). The FASB will separately consider the impact of joint decisions on financial reporting for interim periods in the United States.
- To publish a single Exposure Draft for Segment A issues; through use of the Exposure Draft and public meetings and communication documents, to explain fully the rationale for and benefits of the proposed changes to financial statements; and to hold round-table meetings for public discussion of the Exposure Draft.
- Based on these Segment A decisions, the Exposure Draft for Segment A will include:
  - (a) The definition of a full set of financial statements and their prominence in a financial statement package
  - (b) Requirements for the statement of earnings and comprehensive income
  - (c) Required number of full sets of financial statements for annual periods
- Although the proposed Exposure Draft for Segment A will be a single document for both boards, the final standard would amend IAS 1 *Presentation of Financial Statements* (IASB) and create a new standard for the decisions made in Segment A (FASB).

Segment B – fundamental reconsideration

Segment B focuses on more fundamental reconsideration of presentation and display issues for all financial statements, including the recycling and disaggregation issues. On the Segment B topics, the Boards decided:

- To develop a single standard under Segment A and Segment B that would apply broadly to all entities. The scope of the FASB standard, however, would exclude not-for-profit organizations.
- To first develop standards of presentation and display that would apply broadly to all for-profit entities other than financial institutions. Second, to consider the application of those standards to financial institutions.
- To select financial institution members for the subgroup of the Joint International Group on performance reporting. This subgroup will be formed from nominations received during the JIG nomination process in 2004, as well as from existing members of the IASB's working groups on financial instruments and insurance.
- To include in Segment B consideration of SFAS 95 *Statement of Cash Flows*, and IAS 7 *Cash Flow Statements*, including whether to require use of the direct or indirect method and disaggregation and categorisation issues.

The Boards will continue to explore in Segment B the issues of recycling, disaggregation, and related issues (including reconsideration of the statement of cash flows).

Financial instruments – the way forward (joint meeting)

The boards discussed possible approaches for improving the accounting for and reporting of financial instruments, while also converging and simplifying their various standards. Members of both boards agreed that use of a mixed measurement attribute was the primary source of complexity in existing standards. While members of both Boards expressed the view that adopting a single measurement attribute, fair value, would both improve financial reporting and significantly simplify their accounting standards, they differed in their views about whether that solution is attainable in the near future. Members of both boards also agreed that efforts to converge their existing standards through amendments of specific provisions would require a significant commitment of Board and constituent resources for little marginal improvement in financial reporting. As a result of this discussion, the boards decided to work on certain unresolved technical issues, against the time when constituents had more experience of working with fair value.

In particular, the boards directed the staff to analyse two groups of unresolved technical issues related to financial instruments that are currently reported at fair value. One group of issues involve the display of changes in fair value, for example, how to present interest on a debt instrument that is classified as a financial asset or financial liability at fair value through profit or loss and whether to separately present the effects on fair value of changes in exchange rates, interest rates and other factors.

The second group of issues involve scope and measurement issues. Some of these issues are how to distinguish financial instruments from similar contracts, and whether different accounting based on that distinction is appropriate. The issues include, for example, whether some types of financial instruments that are not currently recognised in financial statements should be recognised if they have non-zero fair values, and the measurement of core deposits.

Some members of the boards also expressed some interest in exploring a modified approach for classifying financial instruments based on cash flows of the instrument, but no decision was made.

The boards also directed the staff to begin a research project to develop an approach to derecognition with an initial focus on financial assets that would be an improvement to both IAS 39 *Financial Instruments: Recognition and Measurement* and SFAS 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The boards also directed the staff to consider as a part of that research project the feasibility of developing a broader derecognition standard that would apply to all types of assets. The timing of that research work is dependent on staff availability.

Conceptual framework (joint meeting)

At this meeting, the IASB and FASB began their deliberations to develop a common conceptual framework. The two boards discussed issues relating to the objectives of financial reporting. They reached the following conclusions:

- Financial reports should be prepared from the entity's perspective and should aim to provide information to a wide range of users, rather than focusing on the information needs of existing common shareholders only. The framework should identify the primary users as present and potential investors and creditors (and their advisers). Later in the project, the Boards will consider whether financial reporting should also provide information to meet the information needs of particular types of users, such as different types of equity participants.
- The objective is to provide information about the entity to the external users who lack the power to prescribe the information they require and must therefore rely on the information provided by an entity's management. The entity's management will also be interested in that information. However, because management has the power to obtain the information it requires, any additional information needs of management are beyond the scope of the framework. Similarly, certain external users, for example, a credit rating agency or a bank lender, generally have the power to prescribe the information they require and their additional information needs may therefore be beyond the scope of the framework.
- As discussed in the two boards' existing frameworks, the financial statements should provide information to help users to assess an entity's liquidity and solvency. However, that objective should be consistent with the overall objective of providing information to a wide range of users. Therefore, the information provided in the financial statements should not be focused on meeting the information needs of particular types of users that primarily use the financial statements to help them assess an entity's liquidity and solvency.
- As with the existing frameworks, the boards' converged framework should be concerned with *general purpose* financial reports, which focus on the common information needs of users. That does not preclude the boards from concluding, in a standards-level project, that additional information should be provided to meet the information needs of particular types of users.

In addition, the boards discussed the relative roles of decision-usefulness and the stewardship or accountability of management. In the two boards' existing frameworks, the overriding objective of financial reporting is to provide information to assist users in making economic decisions. The objective of providing information to help users to assess the stewardship or accountability of management is a subset of the decision-usefulness objective. The boards asked the staff to investigate further the meaning of 'stewardship' and 'accountability', and the implications of having such an objective in the framework. The boards will then discuss further whether the stewardship/accountability objective should be retained or eliminated from the conceptual framework.

Meeting dates: 2005

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

16—20 May

20—24; 27 and 28† June

18—22 July

19—23; 26 and 27ǂ September

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

10 and 11†; 14—18 November

12—16 December

† Includes a meeting with the Standards Advisory Council

ǂ Includes meetings with world standard-setters

