

The International Accounting Standards Board met in London on 19– 22 July, when it discussed:

- Financial Instruments Working Group meeting
- European roadshows
- Conceptual Framework
- Income taxes: short-term convergence
- Financial Reporting by Small and Medium-sized Entities (SMEs)
- Extractive activities
- Consolidation (including special purpose entities)
- Insurance Contracts (phase II)
- Agenda Review

Financial Instruments Working Group meeting

The staff updated the Board on discussions at the third meeting of the Financial Instruments Working Group (FIWG) held in London on 15 July 2005. The discussions focused on three topics:

- The decisions taken at the joint meeting of the IASB and the FASB in April
- Disaggregation of fair value income
- Determining interest in a fair value model

As regards financial instruments, the boards' conclusions at their joint meeting were as follows:

- Although members of both boards expressed the view that adopting a single measurement attribute—fair value—would improve financial reporting and significantly simplify their accounting standards, they differed in their views about whether that solution was attainable in the near future.
- The boards agreed that efforts to achieve the convergence of their financial instruments standards by amending specific provisions would require a significant commitment of board and constituent resources for little marginal improvement in financial reporting.
- Therefore, the boards decided to work on various unresolved technical issues related to financial instruments recognised at fair value (specifically

scope and display of changes in fair value).

In addition the boards also directed the staff to start work on 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*.

At the July meeting the FIWG were reminded that the FIWG's role is to assist the Board in improving, simplifying and ultimately replacing IAS 39, and that short-term revisions to IAS 39 were not the focus of the group's work but rather a by-product of the FIWG's work.

The FIWG's discussion of the boards' April decisions included the following:

- Some FIWG members thought that the relevance of a full fair value model was unproven for many businesses.
- Some FIWG members noted that the reliability of measurement needed to be addressed before moving to a full fair value model.
- Members noted that a full fair value model would not necessarily reduce the complexity associated with accounting for financial instruments—for example, cash flow hedge accounting and derecognition would still have to be addressed.
- Some FIWG members thought that the IASB should 'fix' and improve IAS 39, given that a move to full fair value was unlikely to happen in the short to medium term, and that short-term changes and improvements to IAS 39 could be combined with consideration of the implications for a full fair value model.

The FIWG discussed the disaggregation of fair value income and noted that this is as relevant to a mixed attribute model (such as IAS 39) as it is to a full fair value model. Some FIWG members argued that disaggregation by cause (for example, fair value changes due to changes in foreign exchange rates and interest rates) would provide valuable information to users of financial statements, even though any such

requirement could introduce complexity for preparers of financial statements. FIWG members also saw disaggregation by reliability of measurement or by how management views the business as useful bases to display fair value income. Other FIWG members commented that disaggregation of gains or losses on instruments held for trading or by type of instrument was not necessary or useful given the dynamic nature of trading activities and, therefore, that such information was rapidly out of date.

The FIWG's discussion on determining interest within a fair value model included:

- Some FIWG members questioned whether 'interest' has any real meaning for instruments measured at fair value, and that a better label might be 'change in fair value due to the passage of time'.
- Other FIWG members thought that the disclosure of interest would play an important role when, for example, management intends to hold an asset until maturity or a portfolio of assets is managed on an amortised cost basis.
- In addition, some FIWG members noted that because interest payments represented some of the contractual rights and obligations associated with a financial instrument, disclosure of such information would be important.

(continued...)

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European roadshows

As announced in a press release on 3 June, the IASB is participating in a series of 'roadshows' in Europe. The roadshows provide an opportunity for leading members of the local business community to discuss the IASB's work programme and priorities with IASB members and staff, raise matters of concern and offer the IASB advice.

At this meeting, the staff gave a preliminary report on comments received during visits to 14 European countries in June and July. The Board will receive a more detailed report after visits to four other countries, planned for September and October. More information about these meetings is available at: <http://www.iasb.org/resources/conferences.asp>.

Conceptual Framework

The Board continued its deliberations on the joint IASB/FASB conceptual framework project. The Board discussed issues relating to (a) the meanings of stewardship and accountability and their relationship to objectives of financial reporting, and (b) relationships between qualitative characteristics of financial reporting information and how they are used in building decision-useful financial reports.

Stewardship and accountability

The Board agreed that *stewardship* or *accountability* should not be a separate objective of financial reporting by business entities in the converged framework. The Board agreed that the converged framework should clearly describe its meaning of *stewardship*, which encompasses management's responsibility not only for the custody and safekeeping of assets entrusted to it but also for their efficient and profitable use. As a consequence, the Board agreed that the converged framework should clarify that financial information useful for making investment, credit, and similar resource allocation decisions – the primary objective – would include financial information useful for assessing management's stewardship. Board members suggested that the framework also recognise that the terms *stewardship* and *accountability* are used with different meanings in different jurisdictions.

Qualitative characteristics of financial reporting information

The Board agreed that staff should further develop a description of how qualitative characteristics of financial reporting information are used to build decision-useful financial reports. Board members observed that the different qualitative characteristics, which include relevance, faithful representation, comparability, understandability, and their sub-qualities, sometimes suggest different answers to standard-setting and financial reporting issues. Previously, discussion of such differences has focused on hierarchy (ie which characteristics prevail over others because they are ranked higher) or bargaining (ie how much of one quality we are willing to 'trade-off' to get more of another quality.) The Board agreed that it would be better to view consideration of the qualitative characteristics of financial reporting information as steps in a *process* that results in decision-useful financial reporting. Board members suggested several improvements to the description and illustration of the process proposed by the staff. The FASB will separately discuss the same issues on 27 July 2005.

Income taxes: short-term convergence

The Board considered papers on two issues:

- guidance on tax base and
- special deductions.

Guidance on tax base

The Board decided to add guidance to IAS 12 *Income Taxes* as follows:

- implementation guidance on how to derive a tax balance sheet. The staff noted that clarification was needed in some examples to separate the determination of the tax base from the fact that a temporary difference does not exist if there are no taxable consequences of recovering an asset. The Board asked that the proposed guidance regard the process as a whole, rather than splitting the derivation of the tax balance sheet into separate steps of a mechanical double entry followed by adjustments to reflect the deductions available (see observer notes). The Board also noted that it would be helpful (1) to discuss how the temporary difference approach builds up from a timing difference approach, (2) to include all the years in question separately in the examples, and (3) to distinguish clearly the fact pattern presented in each example from the consequences of the fact pattern.
- guidance on the tax base when different deductions are available depending on whether an asset is used or sold. The Board asked the staff to develop an example that illustrates the potential impairment of an asset that was recovered in a way that did not result in the tax deductions supporting the tax base being available.
- guidance on the tax rate to use when different rates are applicable depending on whether an asset is used or sold. The principle would be in the Standard, with illustrative examples in implementation guidance.
- guidance on the tax base when different deductions are available depending on whether an asset is sold separately or in a single-asset entity. The principle would be in the Standard, with illustrative examples in implementation guidance.
- procedures for the computation of deferred taxes. This would be implementation guidance. The Board asked the staff to ensure that the procedures covered consolidation adjustments in addition to the deferred taxes arising in the individual entities within a group.

The Board decided to amend the descriptions of cost and fair value in IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets* and IAS 40 *Investment Property* to clarify that cost (on initial recognition) means fair value assuming full deductibility for tax purposes of the amount paid.

Special deductions

The Board asked the staff to consider the treatment of special deductions and the treatment of uncertain tax positions to determine whether there are similar issues that should be treated consistently. The Board also asked the staff to consider whether an approach consistent with the Board's proposed amendments to IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* should be applied to special deductions.

Format of the Exposure Draft

The Board considered whether, in developing the exposure draft of the proposed amendments to IAS 12, it should also restructure IAS 12 to make it easier to understand. The Board decided to try rewriting IAS 12 so as to leave the requirements unchanged (except for those amendments proposed in this project), but to highlight the principles and to extract the examples and reasoning that would, in an IFRS, form part of implementation guidance and the basis for conclusions.

Financial Reporting by Small and Medium-sized Entities (SMEs)

The Board held an educational session on two issues relevant to the project on financial reporting by small and medium-sized entities (SMEs).

- **Bank lending to SMEs.** The SME research director and chief economist of a major United Kingdom bank explained his bank's approach to initial lending decisions for borrowings by various size categories of SMEs. He discussed when and how financial statements are used in lending, including whether adjustments are made to the data in the financial statements; which information is not found to be useful, and why; and which information is missing that lenders would like to have.
- **FRSSE.** The chair of the committee of the United Kingdom Accounting Standards Board (ASB) responsible for developing and maintaining the UK's Financial Reporting Standard for Smaller Entities (FRSSE) discussed the features of the FRSSE, implementation of the FRSSE by UK SMEs, and acceptance of the resulting financial statements by users. She explained the criteria the ASB had used to make simplifications in disclosure, presentation, recognition and measurement requirements for those matters covered in the FRSSE and what is required of an SME when the FRSSE does not address a particular accounting issue.

The session was educational, and the Board was not asked to make any decisions.

Extractive activities research project

The Board held an education session for the extractive activities research project. This session continued from the presentations on minerals and oil and gas reserves and resources in April 2005 and provided the Board with a further opportunity to ask questions about the key components of the definitions of reserves and resources that are used in each industry. Representatives from the Society of Petroleum Engineers Oil & Gas Reserves Committee, the Australasian Joint Ore Reserves Committee, and the Combined Reserves International Reporting Standards Committee who are providing technical advice to the project team were present. In this session, some of the possible approaches for defining reserves and resources for financial reporting purposes were discussed. Some initial support was indicated for exploring the use of a generic definition of 'resources' for recognition purposes (on either a historical cost or a current value basis) that encompasses minerals and oil and gas reserves and resources. Under that approach, disclosures supporting the recognition and measurement of 'resources' (as generically defined) could be based on or be similar to the existing industry-developed reserves and resources definitions. No decisions were made.

The materials for the presentations are in the observer notes for this meeting at: <http://www.iasb.org/meetings/july2005.asp>

Consolidation (including special purpose entities)

The staff reported on progress since November 2004, when the Board last discussed this project. At that time the Board asked the staff to prepare an Exposure Draft to incorporate into IAS 27 *Consolidation and Separate Financial Statements* the extensive material and guidance that the Board had developed on the concept of control. However, the Board also decided that before publishing this Exposure Draft it needed to consider several issues further.

The Board considered a paper identifying issues in determining the timing and development of a revised standard on control.

The Board discussed a draft of the project plan but did not make any decisions. The staff indicated that at its September meeting the Board will be asked to consider papers on the accounting for currently exercisable options and the comparison of an option over an asset and an option over an entity.

The timing of an exposure draft is dependent on consideration of whether the model proposed will be able to adequately address SPEs. The staff are assessing this matter and will present papers to the Board in due course.

Insurance Contracts (phase II)

The Board:

- held an education session on life insurance, led by Stefan Engländer and Keith Nicholson of KPMG.
- received a briefing by the staff of the US Financial Accounting Standards Board (FASB) on risk transfer in insurance and reinsurance contracts, as well as a brief update on other FASB activities relating to insurance contracts.

The materials for these sessions are available at <http://www.iasb.org/meetings/july2005.asp>. No decisions were made.

Next steps

The Insurance Working Group meets in London on 26 and 27 July. Observer notes for this meeting are available at http://www.iasb.org/meetings/wg_obs_ins.asp.

Agenda Review

The Board reviewed its future agenda, but did not make any decisions. Agenda proposals will be presented at a future meeting. By way of background to the review, the Director of Technical Activities drew attention to the announcements in April by the European Commission and the US Securities and Exchange Commission that encourage the convergence of IFRSs and US GAAP. She also noted that the IASB needs to balance its work programme and requests for new agenda topics with the staff and Board resources available.

The Board asked the staff to prepare proposals for presentation at its September meeting on the following potential agenda items:

- Fair value measurement guidance
- Emission rights.

Meeting dates: 2005

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

19—23 September

17—21 October

24—25 October (joint with FASB) Norwalk, Connecticut, USA

10 and 11[†]; 14—18 November

12—16 December

[†] Includes a meeting with the Standards Advisory Council

[‡] Includes meetings with partner standard-setters