

IASB Update is published as a convenience to the Board's constituents. All conclusions reported are tentative and may be changed or modified at future Board meetings.

Decisions become final only after completion of a formal ballot to issue a Statement, Interpretation, or Exposure Draft.

The International Accounting Standards Board met in London on 24 – 26 April, when it discussed:

- Financial instruments
- Revenue recognition
- Business Combinations II
- Conceptual Framework
- Insurance
- Financial instruments puttable at fair value
- Consolidation
- Liabilities and equity

The IASB also met with the Financial Accounting Standards Board in a joint meeting on 27 and 28 April, where they discussed:

- Financial instruments
- Revenue recognition
- Business Combinations II
- Conceptual Framework
- Leases

Financial instruments

In preparation for its meeting with the FASB, the Board discussed a paper considering the Board's long-term objective to simplify or eliminate the need for special hedge accounting requirements. The Board also discussed possible contents of the due process document on financial instruments to be developed in accordance with the Memorandum of Understanding with the FASB. No decisions were made.

Revenue recognition

In preparation for the meeting with the FASB, the Board continued its discussion about revenue recognition methods. No decisions were made.

Business Combinations II

The Board is currently redeliberating its proposals to revise IFRS 3 *Business Combinations*. The project is being undertaken with the FASB, with the objective of improving and converging the accounting for business combinations under IFRSs and US GAAP. The staff clarified the approach it proposes to use to guide the boards' redeliberations of the proposals.

The principles that the boards will use as a framework for their redeliberations were published in the March issue of *IASB Update*.

This approach to the redeliberations reflects the commitment both boards have to developing principle-based standards. Using the approach of determining first the basic principles to provide a framework for the redeliberation does not mean that the Board will not consider or address concerns constituents raised in the comment letters.

The staff noted that the principles themselves have been modified from those in the exposure drafts. Importantly, neither the IASB nor the FASB have yet considered all of the implications of applying these principles. That is to say, many of the matters raised by respondents will be considered by the boards as they deliberate each aspect of the proposals. For example, in May the boards will begin looking at the circumstances when it is appropriate to depart from the principle of measuring each acquired asset at its acquisition-date fair value. The boards have still to consider many aspects of the implications of the fair value measurement guidance, measuring intangibles, contingencies, contingent consideration, measuring goodwill and measuring NCI. Final decisions on the standard will not be made until all aspects of the proposals have been redeliberated.

The boards are not sufficiently advanced in the redeliberation process to be able to assess whether any aspects of the proposals will need to be re-exposed.

IASB Board members and staff are continuing to meet respondents and other constituents to discuss the proposals.

Conceptual Framework

Reporting entity

The Board continued its discussion on the reporting entity phase (Phase D) of the project. At this meeting, the Board discussed the meaning of control in the context of one entity having control over another. The Board decided that:

- control, in this context, should be defined at the concepts level;
- the definition of control should contain both a power element and a benefits element, together with a link between these two elements;
- the power element should refer to the entity's ability to direct the financing and operating policies of another entity;
- the benefits element should refer broadly to benefits or economic benefits, and no minimum level of benefits should be specified; and
- the conceptual framework should explain that determining whether one entity has control over another entity involves an assessment of all the facts and circumstances.

Distinguishing liabilities from equity

The Board began its discussion of the conceptual distinction between liabilities and equity by considering four possible approaches. Most Board members expressed support for basing that distinction on both the obligation to sacrifice economic resources and the conveyance of ownership returns, risks, and rights. The Board made no decisions related to this issue at this meeting.

Copyright © IASB Update is published after every IASB meeting by the IASCF, Publications Department, 30 Cannon Street, London, EC4M 6XH United Kingdom
Tel: +44 (0)20 7332 2730
Fax: +44 (0)20 7332 2749
Website: www.iasb.org
Email: publications@iasb.org
ISSN 1474-2675

Other discussions

The Board also discussed other issues relating to the definitions of an asset and a liability of an entity (in preparation for the joint meeting with the FASB) and a staff paper on the process to deal with the measurement phase (Phase C). The Board also received a report on the progress of the upcoming due process document that discusses the objectives and qualitative characteristics of the framework, and status of other aspects/phases of the framework project.

Insurance

The Board discussed the measurement attribute for insurance liabilities, the unit of account, unbundling and profit margins.

As a follow up to its discussion in March, the Board also confirmed that it does not intend to develop guidance in this project on how to determine a discount rate for maturities beyond the term of instruments traded in observable markets, or for currencies in which there is little or no market in risk-free instruments.

Measurement attribute

The Board continued its discussion of approaches that aim to measure insurance liabilities using the following inputs:

- current unbiased probability-weighted estimates of future cash flows.
- current market discount rates that adjust the estimated future cash flows for the time value of money.
- an estimate of the margin that market participants require for bearing risk and providing other services.

The Board noted that these approaches provide:

- useful information about the amount, timing and uncertainty of future cash flows arising from existing insurance contracts.
- a single treatment for all changes in estimates of cash flows.
- a principle-based framework that will make it easier to resolve new issues when they emerge.
- consistency with other IFRSs that require current estimates of future cash flows in measuring non-financial liabilities (see IAS 37) and financial liabilities (see IAS 39).
- margins that are explicit and reflect the extent to which the insurer is released from risk during the period.
- clearer identification of economic mismatches between insurance liabilities and related assets measured at current values.

At this meeting, the Board discussed two possible ways to implement these approaches. Both possibilities would estimate the cash flows in the same way and use the same discount rates. One possibility (previously labelled as current entry value) places more emphasis on calibrating the margin to the observed price for the transaction with the policyholder, and prohibits the recognition of net gains at inception. Several Board members indicated a preference for that possibility.

However, the Board decided that the discussion paper should express the Board's preference for the other possibility, which puts more emphasis on the need to estimate the margin another party would require if it took over the insurer's contractual rights and obligations. Specifically, the Board decided the following:

- The measurement attribute for insurance liabilities should be current exit value, both at initial recognition and subsequently. Current exit value should be defined as the amount that the insurer would expect to have to pay today to another entity if it transferred all its remaining contractual rights and obligations immediately to that entity (and excluding any payment receivable or payable for other rights and obligations).
- It follows that an insurer would not be prohibited from recognising a net gain (ie net after acquisition costs) or net loss at the inception of an insurance contract. However, if an insurer identifies an apparently significant gain or loss at inception, it would need to check carefully for errors or omissions.
- It is too early to conclude whether current exit value is synonymous with fair value. The Board will review that question as work proceeds on the fair value measurement project.

The Board also decided that the measurement attribute used for the insurance liability should also be used for the recognised portion of the customer relationship (ie the portion that relates to future payments that the policyholder must make to retain a right to guaranteed insurability, see Update February 2006).

Moreover, an insurer should present the recognised portion of the customer relationship as part of the related liability, not as a separate asset. The staff will investigate how best to provide useful disclosure about the extent to which the liability incorporates cash flows that are enforceable.

Using current exit value as the measurement attribute is not intended to imply that an insurer can, will or should actually transfer the liability to a third party. Indeed, in most cases, insurers cannot transfer the liabilities to a third party and would not wish to do so. Rather, the purpose of specifying this measurement attribute is to provide useful information that will help users make economic decisions. Current exit value is more suitable for this purpose than other approaches the Board has considered over the last few meetings because it:

- emphasises current estimates of the amount, timing and uncertainty of those cash flows, and of the price for those cash flows and
- uses observable market inputs, to the extent they exist.

Unit of account

The Board discussed whether risk margins should include or exclude the effects of diversification within a portfolio of insurance contracts, between different portfolios of insurance contracts or with the insurer's other assets and liabilities. The staff will investigate these issues further.

Unbundling

The Board decided that it should not require insurers to unbundle deposit and service components of insurance contracts for the purpose of recognition and measurement. The staff will investigate whether unbundling should be prohibited in some or all cases. The staff plans to ask the Board in May whether premiums should be recognised always as revenue, always as deposit receipts, or sometimes as revenue and sometimes as deposit receipts.

The Board also discussed contracts that link the benefit amount directly to the fair value of a designated pool of assets operated in a way similar to a mutual fund. The staff explained an approach in which an insurer would not recognise those assets,

and the related part of the obligation to pay policyholder benefits, if the insurer has a contractual obligation to pay all cash flows from those assets to the policyholders. The criteria for assessing whether such an obligation exists would be based on the derecognition criteria for pass-through arrangements in paragraphs 19 and 20 of IAS 39 (see observer notes at www.iasb.org/meetings/april2006.asp for details). The Board instructed the staff to continue working on this approach and to consider how the proposed criteria might operate in bankruptcy.

Profit margins

The Board decided that the measurement of insurance liabilities should incorporate a margin that represents an unbiased estimate of the compensation that market participants would demand not only for bearing risk (a risk margin), but also for providing other services (a profit margin).

Next steps

The Board expects to continue its discussions in May. Among other things, the Board will discuss the following items carried forward from the April agenda: universal life contracts, unit-linked and index-linked payments, credit characteristics of insurance liabilities.

Financial instruments puttable at fair value

At its meeting in December 2005, the Board decided to amend IAS 32 *Financial Instruments: Presentation* to require equity classification of financial instruments puttable at the fair value of a pro rata share of the net assets of the entity ('financial instruments puttable at fair value') and financial instruments that entitle the holder to a pro rata share of the entity's net assets on liquidation, provided that specified criteria are met.

At its meeting in March 2006, the Board considered issues arising from comments of Board members and others on a draft Exposure Draft of the proposed amendments. At this meeting, the Board continued its discussion on an analysis of costs and benefits of the proposed amendments, which was an issue carried over from the previous meeting.

In the Board's view a major benefit of the proposed amendments is that they will yield more relevant and understandable information for users of financial statements, but at the cost of increased complexity in IAS 32's requirements.

The Board concluded that overall the benefits outweighed the costs of the proposed amendments. Its views will be set out in the Basis for Conclusions to the Exposure Draft.

Consolidation

The Board held an education session on FASB interpretation FIN46R Consolidation of Variable Interest Entities – An Interpretation of ARB No 51. The materials for the presentation are in the observer notes for this meeting at: www.iasb.org/meetings/april2006.asp. No decisions were made.

Liabilities and equity

The Board held an education session on the FASB's Liabilities and Equity project. The session was led by the FASB project team and discussed the conclusions reached to date. The materials for the presentation are in the observer notes for this

meeting at: www.iasb.org/meetings/april2006.asp. No decisions were made.

Joint Meeting – IASB and FASB

The IASB also met with the Financial Accounting Standards Board in a joint meeting on 27 and 28 April.

Financial instruments

At the meeting the boards agreed to a goal of issuing a due process document on financial instruments (as envisaged in the Memorandum of Understanding between the FASB and IASB) before 1 January 2008. The boards directed the staff to prepare a paper outlining the possible contents of the document, including whether it should contain any preliminary board decisions, and proposing a draft timetable.

Revenue recognition

Before the joint meeting, each board had discussed two revenue recognition methods.

Under the first method, revenue would be recognised when the obligation to provide goods, services or other rights is extinguished. This is deemed to be when the customer obtains the right to use or benefit from the goods, services or other rights.

Under the second method, revenue would be recognised as the entity's production process creates or enhances assets for customers. This is deemed to be when the entity carries out acts to fulfil its contractual obligations to provide goods, services or other rights to the customer.

At this meeting, the boards considered some alternatives that could bridge these two methods.

The boards decided that the notion of customer acceptance was important in determining when revenue should be recognised. They further decided that acceptance should mean that the entity has obtained an unconditional right to consideration (and, correspondingly, that the customer has incurred an unconditional obligation). That right might arise under the contract terms or the operation of the relevant contract law.

The boards noted that determining revenue recognition by reference to customer acceptance could be viewed as a modification of the first method above. This is because customer acceptance would indicate that the entity has been released from part of its obligation. It could also be viewed as modification of the second method, because customer acceptance would be an external validation of the entity's performance to date.

Accordingly, the boards instructed the staff to explore revenue recognition based on the following criterion:

Revenue shall be recognised if the customer must accept performance to date. That is, the contract's legal remedy for breach is, or is like, specific performance or in the event of customer cancellation, the customer is obligated to pay damages reflecting performance to date.

Business Combinations II

The boards considered three matters as part of their redeliberations of their exposure drafts in the business combinations project.

Acquisition-related costs

The proposals would require that acquisition related costs, such as legal and due diligence costs, be accounted for separately from the business combination. This would be a change from current practice of including those costs in goodwill.

Most respondents disagreed with the proposals, mainly on the basis that they preferred a cost accumulation model. The exception was analysts, who generally supported the proposed treatment. The staff recommended that the boards affirm the proposed treatment on the basis that it is consistent with the principles underpinning the proposals and meets the information needs of users identified by respondents. The staff presented an analysis demonstrating that the proposed disclosures will allow users to identify the total cost of the acquired assets and liabilities of the acquiree and the associated acquisition-related costs. Both boards affirmed the ED proposal.

Presentation and Disclosure of Non-controlling Interests

The boards considered the presentation and disclosure requirements in their separate non-controlling interests Exposure Drafts (NCI EDs) and decided that the requirements should converge as follows:

- The FASB decided (as proposed in the IASB NCI ED) to require entities to present, either on the face of the statement of changes in equity or in the notes, a reconciliation of the carrying amounts at the beginning and the end of the period for each of total equity, equity attributable to equity holders of the parent and non-controlling interest. Each reconciliation would disclose separately changes resulting from:
 - (a) profit or loss/net income;
 - (b) transactions with equity holders acting in their capacity as equity holders, showing separately distributions to equity holders; and
 - (c) each item of income or expense recognised directly in equity/other comprehensive income.
- The IASB decided (as proposed in the FASB NCI ED) to require entities to disclose, in the notes to the consolidated financial statements, a separate schedule that shows the effects of any transactions with the non-controlling interest on the equity attributable to the controlling interest.
- The IASB decided (as proposed in the FASB NCI ED) that if control of a subsidiary is lost, the entity should disclose the amount of gain or loss related to the remeasurement to its fair value of any retained non-controlling equity investment in the former subsidiary and the line item in the income statement where that gain or loss is recognised.

The boards also affirmed the proposal in both NCI EDs that a parent with one or more partially-owned subsidiaries should be required to disclose, either in the notes or on the face of the financial statements, amounts attributable to the controlling interest for the following, if reported in the financial statements:

- (a) income from continuing operations;
- (b) discontinued operations;
- (c) extraordinary items (FASB only); and

- (d) items of income or expense recognised directly in equity/other comprehensive income.

Fair value measurement guidance

The staff presented an assessment of how changes that are likely to be made to the fair value measurement guidance might affect the business combinations proposals. In particular, the business combinations proposals included a statement that the consideration transferred by the acquirer is presumed to be the best evidence of the acquisition-date fair value of the acquirer's interest in the acquiree. The staff analysis suggested that this might be inconsistent with the fair value measurement guidance and with recent decisions the boards have made in the Business Combinations project. The staff indicated that they expect to provide the boards with additional analysis when they bring back goodwill measurement. No decisions were made.

Conceptual Framework

The boards continued their deliberations to develop a common conceptual framework.

Definitions of assets and liabilities

The boards considered working definitions of assets and liabilities and their three essential characteristics, which follow.

An asset is a present economic resource of an entity and its characteristics are:

- (a) there is an underlying economic resource;
- (b) the entity has rights or other privileged access to the economic resource; and
- (c) the rights or other privileged access exist at the financial statement date.

A liability is a present economic obligation of an entity and its characteristics are:

- (a) the entity is obligated to act or perform in a certain way (or refrain from acting or performing);
- (b) the obligation exists at the financial statement date; and
- (c) the obligation is economic—it is an obligation of the entity to provide its economic resources to others, or to stand ready to do so.

The boards gave staff directions to assist in further developing the definitions, characteristics and amplifying text that can be used for testing them against examples.

Planning for the Measurement phase

The boards agreed that they will consider all aspects of the measurement portion of the conceptual framework in a single phase rather than considering some aspects as part of phase B, as previously agreed. The staff indicated that the measurement phase (phase C) will be conducted in three milestones. The boards were concerned about the estimated time to complete the measurement phase. However, they acknowledged that, given the difficulties of the subject, the plan proposed by staff was reasonable. They agreed to the need to conduct public consultations and for discussion documents for each milestone.

Objectives and qualitative characteristics

The boards also agreed that the upcoming due process document that discusses the objectives and qualitative characteristics of the framework will be published as a discussion paper that includes the preliminary views of the boards and allows a 120 day comment period.

Leases

The boards held a preliminary discussion on whether to add a project on leases to their agendas. It was agreed that a joint project was preferable. Staff were instructed to develop an agenda proposal and plan for a project that would build on the work carried out in the IASB's joint research project with the UK ASB, and that would initially result in a preliminary views paper. The agenda proposal will be discussed with the SAC before being brought to the boards for approval.

Meeting dates: 2006

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

22—26 May

19—23 June

17—21 July

18—22 September

16—24 October (joint with FASB), Norwalk, Connecticut, USA

13—17 November

11—15 December