BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

November 2006

IASB Update *is published as a convenience for 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 Standard or Interpretation or to publish an Exposure Draft.

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

- Financial instruments
- Post employment benefits
- Service concession arrangements
- Conceptual framework
- Annual improvements process
- Update on IFRIC activities
- Short-term convergence: borrowing costs
- Short-term convergence: joint ventures

Financial instruments

At their joint meeting in April 2006, the IASB and the Financial Accounting Standards Board (FASB) agreed to a goal of publishing a due process document on financial instruments (as envisaged in their Memorandum of Understanding) by January 2008. The boards agreed that this document would, as far as possible, include the preliminary views of each board. At this meeting the Board discussed the recognition and measurement of items within the scope of the due process document.

The Board discussed whether the fair value of all financial instruments could be measured with sufficient reliability for financial reporting purposes. It tentatively decided that, for the purposes of the due process document, the fair value of all items within the scope of the document could be reliably measured.

The Board also discussed the level at which an item should be initially recognised ('unit of account')—as portions of an individual instrument, as the individual instrument itself or using a 'linked' approach that recognised two or more instruments together as an asset or liability. The Board tentatively decided that the unit of account should be an individual instrument, but noted that there may be circumstances in which a 'linked' approach is required.

The Board discussed how items within the scope of the due process document should be initially measured—at the market exit value, the transaction price or market entry value (which in many situations would be the same as the transaction price). The Board decided not to take a preliminary view on this issue.

The Board next discussed the level at which the recognised asset or liability should be aggregated for measurement purposes ('unit of measurement'). The Board tentatively decided that the measurement objective should be to measure fair value at the individual instrument level. However, this requirement would not prevent an entity aggregating similar items into a portfolio and measuring the portfolio, as long as the objective in doing so was to estimate the total fair value of the individual instruments within that portfolio.

The Board tentatively decided that all gains and losses arising on the remeasurement of items in the scope of the due process document should be reported in profit or loss, although the Board will reconsider this preliminary view when it discusses hedge accounting at a future meeting.

Lastly the Board discussed the measurement of contractual financial instruments whose cash flows depend upon whether the other party to the contract exercises an option that would be beneficial to the entity. The example the Board discussed was a credit card contract under which the card holder has the option to borrow money from the card company. If the card holder uses the credit card, and hence exercises the option to borrow, this could be beneficial to the credit card issuer. Transactions in which credit card portfolios are sold to another entity provide evidence that market participants attribute value to the credit card contract under which a cardholder can borrow money. The Board acknowledged that transactions involving the transfer of credit card portfolios provide evidence that an asset exists for an entity that holds credit card contracts. At a future meeting, the Board will discuss whether that entity's ability to benefit from such contracts is best viewed as the right to benefit from an existing contract, or as part of an existing customer relationship.

Post employment benefits

The Board discussed the recognition and presentation of the components of defined benefit pension plans. The Board noted that at a future meeting the staff would present the views of the Employee Benefits Working Group. The Board tentatively decided to require recognition in the period incurred of:

- all actuarial gains and losses, subject to finding an acceptable approach to presentation; and
- unvested past service cost

The Board also tentatively decided that the discussion paper would discuss alternative approaches to presentation, in addition to the preliminary view that all changes to components of defined benefit pension plans would be recognised in profit or loss. The Board directed the staff to develop these alternative approaches for discussion at a future meeting.

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Service concession arrangements

The Board considered points raised at the public meeting it had convened to hear constituents' views on the near-final draft Interpretation. The meeting was attended by over fifty external participants from eight countries, as well as by a majority of the Board. Copies of letters received on the near-final draft had been distributed to all Board members. An audio file of the proceedings at the public meeting had been placed on the public Website.

The Board noted that there was broad support for the project and that many preparers pressed for the Interpretation to be issued as soon as possible. Some of the matters raised had already been subject to full consideration by the IFRIC. The Board considered the desirability of small changes to the near-final draft in respect of two matters: permitted methods of amortisation and the nature of the grantor guarantees addressed in the Interpretation.

The IFRIC noted in its Basis for Conclusions the requirements of IAS 38 *Intangible Assets* regarding amortisation, including the observation at paragraph 98 of IAS 38 that 'for intangible assets with finite useful economic lives, there is rarely, if ever, persuasive evidence to support an amortisation method that results in less accumulated amortisation than would result from applying the straight-line method'. The Board noted that those words had been included in IAS 38 in order to avoid an abuse prevalent at the time, but they should not be read as implying that a method of amortisation based on reliable estimates of usage would never be appropriate. The Board indicated that it would consider amending IAS 38 in this respect as part of its Annual Improvements process. As a result, the Board invited the IFRIC to consider omitting the observation from the Basis for Conclusions on the Interpretation.

The key determinant of the accounting model to be followed under the Interpretation is the extent to which the operator has an unconditional right to receive cash or other financial assets from the grantor for the construction services (paragraph 16). At the public meeting participants observed that guarantees given by the grantor are often restricted to the operational phase of a service concession. However, some of the wording of the Interpretation and accompanying examples gave the impression that all grantor guarantees should be taken into account, rather than only those relating to consideration for the construction services. The Board observed that the Interpretation focused on guarantees of consideration for construction not guarantees for operational services but invited the IFRIC to consider minor textual changes to clarify this point.

The Board considered whether to require an effective date of 1 January 2008, as requested by the IFRIC, or 1 January 2009, to coincide with the implementation date announced for major Board projects. It decided that the effective date should be 1 January 2008.

The Board approved the Interpretation for issue and thanked the IFRIC and the staff for their work on the project. Approval was not subject to the IFRIC making the Board's drafting suggestions.

Conceptual framework

Definition of asset

In its deliberations on Phase B *Elements and Recognition*, the Board discussed the staff's draft definition of an asset.

An asset is a present economic resource to which the entity has a present right or other privileged access.

(a) *Present* means that both the economic resource and the right or other privileged access to it exist on the date of the financial statements.

(b) An *economic resource* is something that has positive economic value. It is scarce and capable of being used to carry out economic activities such as production and exchange. An economic resource can contribute to producing cash inflows or reducing cash outflows, directly or indirectly, alone or together with other economic resources. Economic resources include non-conditional contractual promises that others make to the entity, such as promises to pay cash, deliver goods, or render services. Rendering services includes standing ready to perform or refraining from engaging in activities that the entity could otherwise undertake.

(c) *A right or other privileged access* enables the entity to use the present economic resource directly or indirectly and precludes or limits its use by others. *Rights* are legally enforceable or enforceable by equivalent means (such as by a professional association). Other privileged access is not enforceable, but is otherwise protected by secrecy or other barriers to access.

Board members suggested improvements to the draft definition, primarily related to the explanation of the term *economic resource*. The Board decided to consult some technical experts, as well as the Standards Advisory Council, on a definition modified to reflect the suggested improvements.

FASB members had discussed an earlier draft of the working definition of an asset at their educational session and the proposed definition reflected their suggestions. The FASB will also consult technical experts, as well as its Advisory Committees, using the proposed definition of an asset, including the IASB's suggestions.

Definitions of liability and equity

At this meeting, the Board also discussed whether the Conceptual Framework team should further explore two possible alternative approaches to reconsidering the existing definitions of liabilities and equity and attempt to sharpen the distinction between them. Those alternatives are (1) defining only a single element, such as claims, and (2) defining more than two elements. The Board directed the staff to undertake such explorations, with the emphasis on developing the single element approach, and to consider what the implications of adopting that approach might be.

The FASB had also discussed these topics and reached a similar conclusion.

Annual improvements process

The Board discussed three issues for the annual improvements process. This process is intended to eliminate inconsistencies between standards and to clarify wording. Proposed amendments to standards resulting from this process will be accumulated and published in a single exposure draft each year. The first exposure draft of proposed improvements will be published in October 2007.

Reporting compliance with IFRSs

In some jurisdictions, reporting frameworks are described as being based on IFRSs, but are not fully compliant with IFRSs. Users of financial statements that are based on those frameworks may be misled into thinking that the statements comply, or comply in all but immaterial respects, with IFRSs and make decisions based on that assumption. The Board discussed a proposal to amend IAS 1 *Presentation of Financial Statements* to require disclosures to describe the differences between IFRSs and a reporting framework based on IFRSs. The Board decided to continue discussions on this matter at its meeting in December.

Presentation of finance costs

The IFRIC asked the Board to consider an apparent conflict between the requirements of IAS 1 *Presentation of Financial Statements* and IFRS 7 *Financial Instruments: Disclosures* regarding the presentation of finance costs. Paragraphs 32 and 81 of IAS 1 preclude presenting 'net finance costs' on the face of the income statement without showing separately the finance costs and finance revenue included in the net amount. Paragraph IG13 of IFRS 7 states that total interest income and total income expense are components of finance costs. This indicates a net presentation in the income statement. The Board decided to resolve this conflict by deleting paragraph IG13.

Classification of the liability component of a convertible instrument

The IFRIC asked the Board to clarify the current or non-current balance sheet classification of the liability component of a convertible instrument. The holder of the instrument can require settlement at any time by converting to shares. However, the entity's obligation to settle by delivering cash or other assets is more than 12 months after the balance sheet date. The Board noted that the purpose of current or non-current classification on the balance sheet is to assist users in assessing the liquidity and solvency of an entity. Therefore, the Board decided to amend IAS 1 *Presentation of Financial Statements* to remove equity settlement as a determining factor in the current or non-current classification of liabilities.

Update on IFRIC activities

The staff reported on the November meeting of the IFRIC, details of which were available in IFRIC *Update*. With the improvement in staff resources during the current year, the IFRIC had cleared much of its backlog of work, although several pensions issues remained that would not be covered in phase I of the Board's pensions project. One item from the backlog was resumption of work on aspects of IAS 41 *Agriculture*. The staff reassured the Board that any changes to IAS 41 would be co-ordinated with proposals in the Board's Fair Value Measurements project.

Short term convergence: borrowing costs

The Board discussed comments received from respondents to the proposal in the exposure draft of Proposed Amendments to IAS 23 *Borrowing Costs* to eliminate the option to recognise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as an expense immediately. The Board asked the staff to prepare, for its meeting in December, a paper on the arguments of respondents who disagreed with the proposal and the suggestions they made.

Short-term convergence: joint ventures

The staff reported on their discussions with preparers on the likely practical effects of the Board's proposals. The staff had consulted preparers from the extractive, real estate, pharmaceutical, branded goods and insurance industries.

The proposals regarding direct and indirect interests were expected to have little effect for ventures that involve jointly controlled assets and jointly controlled operations. Some preparers have direct interests in jointly controlled entities that they account for using proportionate consolidation in accordance with IAS 31 *Interests in Joint Ventures*. For those preparers, the proposals would require them to account for their direct interests in the individual assets and liabilities of the entity in accordance with applicable standards. A change from recognising interests in a jointly controlled entity using proportionate consolidation to the recognition of direct interests in the individual assets and liabilities of the entity was not expected to change significantly the amounts recognised. The Board's proposals would require equity accounting only when venturers have indirect interests in a joint venture.

The Board directed the staff to prepare an exposure draft of amendments to IAS 31 based on the decisions taken by the Board at its meetings in December 2005 and March and July 2006.

Meeting dates: 2006 and 2007

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

2006

11—15 December

2007

22—26 January

19—23 February

19—23 March

16—20 April

23—24 April (joint with FASB)

14—18 May

18—22 June

16—20 July

17—21 September

15—19 October

22—24 October (joint with FASB), Norwalk, Connecticut, USA

12—16 November

10—14 December