

*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 18 – 22 September, when it discussed:

- Insurance
- Business Combinations II
- Accounting standards for small and medium-sized entities
- IAS 37 redeliberations
- Conceptual Framework
- Consolidations (including special purpose entities)
- Revenue recognition
- Short-term convergence: segment reporting
- Financial instruments
- Financial statement presentation
- Update on IFRIC activities
- IAS 24 *Related Party Disclosures*
- Fair value measurement
- IFRS 1 amendments
- Technical plan

## Insurance

The Board:

- received a briefing from representatives of the CFO Forum, the Group of North American Insurance Enterprises and four major Japanese life insurers on recommendations those organisations had made for the accounting model for insurance contracts. The Board made no decisions in this educational part of the meeting.
- decided that the forthcoming discussion paper should discuss the components of changes in insurance liabilities and discuss in general terms approaches to presenting and disclosing them, but should not propose specific requirements for presenting and disclosing those changes. The project on presentation

of financial statements will be relevant.

- decided that the discussion paper should document the differences between the Board's tentative conclusions for insurance contracts and existing requirements in IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 18 *Revenue*. The discussion paper will present the Board's preliminary view that it would be preferable to eliminate those differences, but will not propose specific methods for doing so.
- observed that, in principle, the expected (probability-weighted) cash flows from a portfolio equal the sum of the expected cash flows of the individual contracts. Therefore, the unit of measurement does not affect the expected present value of future cash flows. The Board emphasised that unbiased estimates of cash flows reflect all relevant inputs, regardless of whether those inputs are derived contract by contract or in aggregate.
- concluded tentatively that risk margins should be determined for a portfolio of insurance contracts that are subject to broadly similar risks and managed together as a single portfolio. Risk margins should not reflect benefits, if any, of diversification between portfolios and negative correlation between portfolios.
- noted that the unit of measurement is not relevant to the resolution of recognition issues relating to policyholder behaviour, future premiums, renewals and related issues.
- concluded tentatively that an insurer should not unbundle insurance, deposit and service components of insurance contracts if the components are so interdependent that the components can be measured only on an arbitrary basis, but should unbundle them if such interdependencies are not present.
- reaffirmed its prior tentative conclusion that an insurer should recognise a liability relating to expected dividends for participating

policyholders if the insurer has an enforceable obligation (see IASB *Insight* March 2006). The Board noted that an obligation may be enforceable in various ways, including legal action or intervention by a regulator. However, economic compulsion is not sufficient to create an enforceable obligation.

- directed the staff to investigate further the staff's proposal that the face of the balance sheet should distinguish equity attributable to policyholders from equity attributable to shareholders, and the face of the income statement should distinguish profit or loss attributable to policyholders from profit or loss attributable to shareholders.
- continued, from May 2006, its discussion of universal life contracts, focusing on the proposed test for including future premiums (ie guaranteed insurability), the classification (as a liability or as equity) of crediting rates that exceed the minimum that can be contractually required and the interaction of crediting rates with estimates of lapses. The staff will investigate these issues further.

### Next steps

The staff have started to draft a discussion paper, with the aim of publication by the end of the year. The staff expect that the Board will have completed by October a discussion of the remaining significant matters that require its input before the discussion paper can be finalised.

## Business Combinations II

The Board discussed the recognition and measurement of intangible assets acquired in a business combination. The Board tentatively decided that:

- intangible assets that are identifiable (ie arising from contractual-legal rights or separable) can be measured reliably and should be recognised separately from goodwill;
- identifiable intangible assets acquired in a business combination should be measured at an acquisition-date current exchange value rather than at an entity-specific value; and
- the final business combinations standard should include guidance on the initial and subsequent measurement of intangible assets that an acquirer does not intend to use or that an acquirer will use for a period significantly less than the economic useful life of those assets.

## Accounting standards for small and medium-sized entities

The Board continued its discussions of a draft Exposure Draft (ED) of an International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs).

### Financial instruments

The Board considered a revised draft of Section 12 Financial Assets and Financial Liabilities of the ED. The draft reflected the Board's comments on the version of Section 12 discussed at the meeting in July, as well as suggestions made by two independent expert reviewers.

An SME would have a choice of applying either Section 12 or IAS 39 in accounting for financial instruments. Section 12 simplified the provisions of IAS 39 in a number of respects, including:

- Two categories of financial assets rather than four.
- Three types of financial instruments would be measured at cost or amortised cost when specified conditions are met. The types were (a) receivables, payables, and loans, (b) most commitments to make or receive loans, and (c) equity instruments whose fair value cannot be reliably measured and options on such instruments. Types (a) and (b) might optionally be at fair value through profit or loss. All other types of financial instruments would be measured at fair value through profit or loss.
- Section 12 includes a clear and simple principle for derecognition—if the transferor has any significant continuing involvement, do not derecognise. As a result, derecognition would be allowed in fewer circumstances than under IAS 39. This will not affect most SMEs because banks and other financial institutions are publicly accountable and thus not SMEs. Another simplification was that the complex 'pass-through testing' and 'control retention testing' of IAS 39 were avoided. Furthermore, an SME could always choose to use IAS 39 instead of Section 12.
- For hedge accounting, Section 12 addresses the four types of risk hedges that SMEs typically use. Hedge accounting is not allowed for any other types. Additionally Section 12 imposes strict conditions on the designation of a hedging relationship. The benefit for the SME is that if the SME

meets those conditions, hedge accounting provisions are simplified.

The draft of Section 12 the Board discussed includes two alternative approaches to hedge accounting simplification. One imposed strict conditions on the designation of a hedging relationship, with subsequent hedge effectiveness assumed without the need to measure ineffectiveness. The other (a) relaxed the conditions for designating a hedging relationship somewhat and (b) required periodic measurement and recognition of ineffectiveness for all hedging activities, but did not require as a qualifying condition that the hedging relationship was effective within a range of 80-125 per cent. IAS 39 has such a condition, requiring somewhat complex and retrospective calculations.

The Board discussed those two approaches and also a third approach. The third approach would not include any hedge accounting provisions in Section 12 but, instead, would refer SMEs to the hedge accounting provisions of IAS 39 if they wished to use hedge accounting.

The Board concluded that Section 12 should reflect the first approach (strict conditions, effectiveness assumed) and that the Invitation to Comment should describe the second approach (simplified effectiveness measurement) in detail. Respondents should be invited to express their views on the two approaches.

The Board also asked the staff to revise Section 12 as follows:

- Clarify that futures contracts can be hedging instruments.
- Clarify that options cannot be hedging instruments.
- Add guidance on whether and how an SME could make the transition from following Section 12 to following IAS 39 and vice versa.

The Board also tentatively decided that Section 12 should include an appendix of fair valuation guidance from IAS 39.

### Income taxes

The Board discussed a revised draft of Section 29 Income Taxes of the ED. Under the draft, an SME would be required to recognise deferred income taxes on all items of income or expense that are recognised in profit or loss or in equity in one period but, under tax laws or regulations, are included in taxable income in a different period (sometimes called 'timing differences'). An SME would also recognise deferred taxes arising from tax losses and tax credits that, under the law, are available to offset taxable profit or tax payable in future periods, although technically these are not timing differences. The staff characterised this approach as a 'timing differences plus' approach.

The Board tentatively decided that deferred taxes should be recognised on all or most timing differences and on tax loss/credit carryforwards. However, the Board tentatively decided that deferred taxes should be provided in more circumstances than just timing differences and carryforwards—including when differences between the tax basis and carrying amount arise when an asset or liability is initially acquired. The Board also asked the staff to consider—consistently with IAS 12 *Income Taxes*—whether Section 29 should be described as a 'temporary differences' approach, rather than a 'timing differences plus' approach.

The Board discussed problems that an SME might encounter in adopting Section 29 for the first time when its previous national accounting framework did not recognise deferred income taxes. The Board tentatively decided that the principle in Section 29

should be that deferred taxes are recognised on all differences between the tax basis and the carrying amount of assets and liabilities. However, the Board also agreed that an exception should be included on first-time adoption of Section 29 if measurement of deferred taxes would require undue cost and effort.

The Board discussed whether an entity should recognise deferred taxes on unremitted earnings of foreign subsidiaries, associates and interests in joint ventures. The Board tentatively decided that such deferred taxes should not be recognised unless it is probable that the timing difference will reverse in the foreseeable future.

#### **Employee benefits**

The draft of Section 28 Employee Benefits included new paragraphs addressing defined benefit plans. Those paragraphs were based on the relevant paragraphs in IAS 19 *Employee Benefits*. Prior drafts of Section 28 had not addressed defined benefit plans but, rather, had referred SMEs to IAS 19.

The Board agreed that an SME should be required to use the projected unit credit method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost. That actuarial method is generally consistent with the asset and liability definitions and recognition provisions of the *Framework*.

The draft of Section 28 proposed that an SME should recognise actuarial gains and losses in their entirety either in profit or loss or directly in retained earnings, and that the non-recognition and partial recognition (spreading) options of IAS 19 should not be included in the IFRS for SMEs. The Board tentatively decided that the non-recognition and partial recognition options of IAS 19 should not be included in Section 28. However, the Board also tentatively decided not to allow an option to recognise actuarial gains and losses directly in retained earnings. This treatment will also apply to actuarial gains and losses arising in connection with other long-term benefits. Also, an SME should recognise increases or decreases in past service cost in their entirety in profit or loss when they arise.

#### **Inventories**

The Board tentatively decided to exclude from Section 13 Inventories the measurement of inventories held by:

- producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value (above or below cost) through profit or loss; or
- commodity brokers and dealers that measure their inventories at fair value less costs to sell through profit or loss.

#### **Revenue**

Guidance on accounting for construction contracts should be included in Section 23 Revenue, rather than requiring SMEs always to look to IAS 11 *Construction Contracts*.

#### **Impairment**

Section 27 Impairment of Non-financial Assets should address how to allocate an impairment loss to individual assets when a group of assets is tested for impairment.

Guidance on how to measure goodwill impairment should be included in Section 27, rather than cross-referring to paragraphs 80-99 of IAS 36 *Impairment of Assets*.

## **IAS 37 redeliberations**

The Board began its redeliberation of issues associated with the measurement principle proposed in the IAS 37 Exposure Draft (ED). This principle would require an entity to measure a liability at the amount that it would rationally pay to settle the obligation or to transfer it to a third party at the balance sheet date.

#### **Scope of the proposed amendments**

The ED explained that the Board had previously decided to limit the scope of its amendments to clarifying the existing IAS 37 measurement principle and aspects of the accompanying guidance. Therefore, the ED emphasised that the IAS 37 measurement principle is based on a current settlement notion—ie the amount to settle or transfer a present obligation *on the balance sheet date*.

However, the Board noted that many respondents to the ED did not share its understanding. Rather, they understood the IAS 37 measurement principle to be an ultimate settlement notion—ie the amount estimated to be required to extinguish the obligation in the future. Consequently those respondents regarded the amendments proposed in the ED as more significant than the Board had intended.

In the light of these comments, the Board began its redeliberations by affirming its understanding that the existing IAS 37 measurement principle is based on a current settlement notion and therefore its decision to limit the scope of amendments to the measurement principle in this project. In reaching this conclusion, the Board acknowledged that the wording of the existing IAS 37 measurement principle and accompanying guidance was not always clear. In particular the Board noted that the term ‘best estimate’ might be read to imply that a single point estimate rather than an expected cash flow approach could be used to measure a liability within the scope of IAS 37.

#### **Further clarification**

The Board noted respondents’ concerns that the proposed measurement principle (i) would permit a choice; (ii) did not provide useful information about liabilities within the scope of IAS 37; and (iii) could not be applied in practice (even if the conceptual merits of a current settlement notion were accepted).

#### **Choice**

The proposed measurement principle expresses a current settlement notion using two different phrases—the amount to settle or the amount to transfer the obligation to a third party at the balance sheet date. The Board began discussing whether the amount to settle a liability at the balance sheet date is the same as the amount to transfer a liability at the balance sheet date (and therefore whether the measurement principle permits a choice). The Board intends to continue its discussion at a future meeting and instructed the staff to prepare an analysis of this issue for further discussion.

#### **Useful information**

The Board tentatively decided that the Basis for Conclusions accompanying any final Standard should include an explanation of how a measurement principle based on a current settlement notion provides useful information about liabilities within the scope of IAS 37. In particular, the Board noted that:

- many respondents equated ‘reliability’ with how close an entity’s estimate was to the actual cash flow required to settle an obligation. However, a difference between an entity’s estimate and the actual cash flow required to settle

an obligation normally does not mean that an entity's estimate was 'wrong'.

- the subjectivity required to measure a liability based on a current settlement notion is no greater than the subjectivity required to measure a liability based on an ultimate settlement notion.

The Board also directed the staff (i) to include issues associated with the probability recognition criterion (currently in IAS 37) in any explanation; and (ii) to consider the extent of disclosure needed to assist users to understand liabilities measured using more uncertain estimates.

### **Application**

The Board tentatively decided that any final Standard should include more guidance on how to apply a measurement principle based on a current settlement notion than is presently in IAS 37.

The Board then discussed how to balance its tentative decision to limit the scope of amendments to the existing IAS 37 measurement principle and guidance in this project with the need to provide more guidance on how to apply the measurement principle. The Board directed the staff to focus on clarifying the measurement guidance in the ED and explaining the attributes of the information required to estimate a liability on the basis of a current settlement notion.

## **Conceptual Framework**

At this meeting, the Board discussed (a) the reporting entity concept and (b) the definition of an asset, as applied to options. The Board also discussed comments received on the Discussion Paper on measurement at initial recognition.

### **Reporting entity**

The Board discussed issues considered at previous Board meetings and the remaining cross-cutting issues for the reporting entity phase of the conceptual framework project. The Board's decisions are summarised below.

#### **Individual entity**

The Board had previously tentatively decided (December 2005) that the reporting entity concept should not specify which entities should be required to prepare general purpose external financial reports (GPEFR). Rather, an entity that chooses, or is required (eg by legislation), to prepare GPEFR would be a reporting entity. Also, the Board had previously tentatively decided (March 2006) that what constitutes an entity for financial reporting purposes should not be limited to legal entities. Rather, an entity can result from other types of arrangements or organisational structures that could be broadly described as circumscribed areas of economic interest. Examples include a company, trust, partnership, association, sole proprietorship, natural person and, in some circumstances, a branch or segment.

The Board tentatively decided that the conceptual framework should describe what constitutes an entity for the purposes of financial reporting, along the lines set out above, but should not define it.

#### **Group entity**

The Board tentatively decided that a group entity for financial reporting purposes should be distinguished from the parent entity. For example, if a parent has one subsidiary, then there are three entities that could be the subject matter of GPEFR—the parent entity, the subsidiary entity and the group entity. The appropriate way of presenting information about assets and

liabilities in each entity's financial statements would be determined at the standards level.

The Board also tentatively decided that the control concept should be used to determine the composition of a group entity. The largest possible group is the ultimate parent and all entities under its control (including both subsidiaries under its direct control and lower-level subsidiaries under its indirect control). It would also be possible to prepare GPEFR for a sub-group of entities that are part of the larger group. For example, a sub-group might comprise an intermediate parent and that entity's subsidiaries, or it might comprise two or more subsidiaries with a common parent. Guidance on possible combinations of entities that are part of the larger group would be provided at the standards, rather than concepts level. However, combinations involving entities outside the larger group would be precluded. In other words, control is the unifying factor. Therefore, a group entity may consist of only those entities that are under the control of the same ultimate parent. Hence, for a combination of two entities in which one entity was not controlled by the other or both were not controlled by the same ultimate parent, the resulting combined financial statements could not be described as GPEFR prepared in accordance with IFRSs.

### **Control issues**

At an earlier meeting (April 2006), the Board tentatively decided that control should be defined at the concepts level, and should contain both (a) a power element and (b) a benefits element, together with a link between the two. The Board also tentatively decided that:

- control is based upon an assessment of all the current facts and circumstances. Therefore, the concept of control includes all situations in which control exists even though it might be temporary.
- the control concept should not be limited to circumstances in which the entity has sufficient voting rights or other legal rights to direct the financing and operating policies of another entity, but should be a broad concept that encompasses economically similar circumstances.
- control cannot be shared, ie control involves a single entity (not multiple entities) having control over another entity.

The Board discussed the relationship between the control concept and situations in which (a) two or more entities collectively have joint control of a joint venture or (b) an entity has significant influence over another entity. The Board tentatively decided that, because control involves a single entity (not multiple entities) having control over another entity, an individual venturer does not have control over the joint venture. Similarly, the fact that an entity has significant influence over another entity does not mean it has control over that other entity.

### **Options**

The Board discussed the treatment of options, first in the context of options over assets and then in the context of control over an entity.

The Board tentatively decided that in the case of an option over an asset, the entity's asset is its present right to the counterparty's contractual promise to deliver the subject matter of the option if it is exercised, rather than a right to the subject matter itself.

When an option holder holds sufficient options that, if exercised, would place it in control of another entity, that is not sufficient, in itself, to establish that the option holder has

present control over that other entity. However, there might be situations in which the holding of options, taken in conjunction with other facts and circumstances, indicate that the option holder currently has control of the other entity.

### Research Project - Measurement Objectives

At this meeting, the Board discussed the summary of the comment letters received in response to the Discussion Paper *Measurement Bases for Financial Accounting — Measurement on Initial Recognition* prepared by staff of the Canadian Accounting Standards Board and published by the IASB in November 2005. No decisions were made.

See IASB Observer Notes for this meeting for the Comment Letter Summary.

## Consolidations (including special purpose entities)

The Board held an education session on interests in entities within the scope of SIC-12 *Consolidation—Special Purpose Entities*. The Board supported a staff proposal that interests in such entities should be accounted for using a model that reflects the rights and obligations of the parties to the arrangement. With this approach there would be a single control model for all entities and consolidation might not be appropriate in all cases. The Board asked the staff to consider the point at which consolidation would not apply based on the characteristics of the arrangement. The Board also asked the staff to do further analysis to enable the Board to understand better the likely impact of the proposed changes. No decisions were made.

## Revenue recognition

The Board discussed how a performance obligation should be measured after initial recognition under the customer-consideration model. Specifically, the Board considered an example of a two-year product warranty, in which estimates about the number of expected claims changed at the end of the first year. (The example is included in the observer notes for the meeting.)

The staff presented two possible approaches for subsequent measurement.

- Under the first approach, all estimates about the performance obligation (ie the obligation to provide warranty coverage) are locked in at inception. Those estimates are not revised until the measurement of the liability is deemed inadequate compared with a direct measure of the liability (eg under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*). In such a case, the liability is remeasured.
- Under the second approach, the subsequent measurement of the performance obligation reflects current estimates of future cash flows. However, the margin used for subsequent measurement is derived from the initial customer consideration amount and is not revised for subsequent changes.

The Board noted that the second approach would be more consistent with the model for non-financial liabilities that is being developed in the IAS 37 project. This is because the measurement under the second approach would reflect current estimates of future cash flows. The main difference between this approach and that under IAS 37 is that IAS 37 also requires a current estimate of the amount and price of risk.

The Board favoured exploring the second approach. However, it expressed concern about not reflecting changes in the amount of risk in a contract such as a warranty, in which the service being provided is risk protection.

The Board also noted that it would need to consider how a change in an estimate of a performance obligation should be reported in profit or loss.

## Short-term convergence: segment reporting

The Board discussed the following issues:

- Possible departures from the management approach in SFAS 131
- The level of reconciliations between segment information and GAAP information
- Disclosure of geographical information, including issues raised by the Publish What You Pay campaign
- Consequential amendments to IAS 34 *Interim Financial Reporting*
- Voluntary disclosure of segment information not in accordance with the IFRS

### Possible departures from the management approach

The Board decided that the IFRS should not define the measures of segment revenues, segment expenses, segment results, segment assets and segment liabilities that are required to be disclosed. In addition, the Board decided that all segments should disclose measures of segment profit or loss and total assets regardless of whether those measures are reviewed by the chief operating decision maker. Further, the Board decided that information about segment liabilities should be disclosed if such information is regularly reviewed by the chief operating decision maker.

### Level of reconciliations

The Board decided that reconciliation to IFRS amounts should not be required at the individual segment level.

### Disclosure of geographical information

The Board decided that issues raised by the Publish What You Pay campaign relating to country-by-country disclosures should not be addressed in the IFRS on operating segments. The Board decided that a sub-group of Board members should discuss the issues with relevant bodies such as the IASC Foundation Trustees, the World Bank, the IMF, the UN, the International Public Sector Accounting Committee and the Financial Stability Forum to determine the best way to address the issues. The Board decided to retain the disclosure requirements of SFAS 131 relating to geographical information.

### Consequential amendments

The Board decided to proceed with the consequential amendments to IAS 34 *Interim Financial Reporting*. The Board also decided that the consequential amendments to paragraph 16(g) of IAS 34 should clarify that the additional interim information on profit and loss items should be disclosed only if the specified amounts are included in the measure of segment profit or loss reviewed by or otherwise regularly provided to the chief operating decision maker.

## **Voluntary disclosure of segment information not in accordance with the IFRS**

At its meeting in July, the Board tentatively decided that if an entity that is not required to apply the IFRS chooses to disclose segment information that does not comply with it, it should disclose that the segment information does not comply with the IFRS. At this meeting, the Board further decided that such disclosures should not be referred to as segment information.

## **Minor issues on ED 8**

The Board decided that:

- The effective date should be 1 January 2009 in accordance with the recently announced IASB policy.
- Early adoption of the IFRS should be allowed before its effective date.
- The guidance in EITF 04-10 should be included in paragraph 13 of the IFRS.
- FASB Q&A 131 – Segment Information: Guidance on Applying Statement 131 should not be included in the IFRS.
- The wording used in ED 8 to exempt entities from disclosures should not be amended to ‘impracticable’.
- The IFRS should include an appendix of defined terms to make it consistent with other IFRSs.
- The quantitative thresholds for determining reportable segments should not be changed.
- The last sentence of paragraph 9 should be deleted to allow matrix form organisations to report segment results in a manner consistent with the management approach.
- Paragraph 12 should make clear the ranking between aggregation criteria and quantitative thresholds.
- It is unnecessary to clarify that the aggregation of segments should be considered in terms of a single currency
- The footnote to paragraph 2 of IFRS 5 should be added to paragraph 23(b) of the ED to define non-current assets based on liquidity presentation.

## **Financial instruments**

### **Due process document**

At the joint meeting held 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 the Memorandum of Understanding between the IASB and FASB) by January 2008. It was agreed that this document would, as far as possible, include the preliminary views of each board.

At this meeting the Board discussed the initial scope of the due process document and possible adjustments to that initial scope.

The Board discussed two possible approaches to setting the scope. The first is to set a broad scope comprising financial instruments and contracts with the same probable outcomes as financial instruments. The second is a narrow scope comprising only financial instruments as defined. The Board decided that the initial scope of the document should be based on a definition of financial instruments. The Board also decided that the scope of the document should not include non-contractual agreements to deliver or exchange a financial instrument, including those imposed by law.

The Board discussed proposed changes (for the purpose of the document) to the existing definitions of a financial instrument in IAS 32 *Financial Instruments: Presentation* and FASB

Statement No. 107, *Disclosures about Fair Value of Financial Instruments*. The Board accepted a working definition proposed by the staff that clarified some issues that had arisen from use of the current definitions. The changes included the removal of references to exchanges that are potentially favourable or unfavourable and confirmation that the definition of financial instruments should apply to separate sets of rights and obligations to deliver or exchange an item in a contract that includes two or more sets of such rights and obligations.

The Board considered a list of possible adjustments to the initial scope of the document. The Board tentatively decided to exclude items that were being addressed in other projects on its agenda. Those items include insurance and related contracts, lease contracts, and pensions and other post-employment benefits. The Board also tentatively decided to consider at a later stage in the project whether to include in the scope of the document contracts that are financial instruments by definition but are not recognised currently (such as some loan commitments, lines of credit and credit card contracts).

The Board also discussed contracts to deliver or exchange an item that are not, by definition, financial instruments.

The Board tentatively decided to include in the scope of the document financial instrument servicing contracts as well as contracts to deliver or exchange a non-financial item that have a probable outcome similar to that of a financial instrument contract or that would meet the IAS 39 definition of a derivative.

### **Derecognition of financial instruments**

The Board discussed a request from the IFRIC for input and advice regarding possible interpretations of two issues relating to the derecognition requirements of IAS 39 *Financial Instruments: Recognition and Measurement*.

The first issue was the meaning of ‘similar’ for groups of financial assets (in paragraph 16) and the possible implications for the subsequent derecognition tests required by IAS 39.

The Board indicated that derivative assets (which are often transferred together with non-derivative financial assets) are not ‘similar’ to non-derivative financial assets for the purposes of IAS 39 paragraph 16. Therefore, an entity would apply the derecognition tests in IAS 39 to non-derivative financial assets (or groups of similar non-derivative financial assets) and derivative financial assets (or groups of similar derivative financial assets) separately, even if they are transferred at the same time. The Board also indicated that transferred derivatives that could be assets or liabilities (such as interest rate swaps) and are transferred would have to meet both the financial asset and the financial liability derecognition tests.

The second issue related to the types of transactions that are required to be treated as pass-through transfers in IAS 39.

The Board discussed whether the pass-through test is applicable to all transfers in which legal ownership of the financial asset is not transferred. The Board indicated that a transaction in which an entity transfers all the contractual rights to receive the cash flows (without necessarily transferring legal ownership of the financial asset), would not be treated as a pass through. An example might be a situation in which an entity transfers all the legal rights to specifically identified cash flows of a financial asset (for example, a transfer of the interest or principal of a debt instrument). Conversely, the pass through test would be applicable when the entity does not transfer all the contractual rights to cash flows of the financial asset, such as disproportionate transfers (see IAS 39 paragraph 16(b)).

The Board also discussed whether conditional transfers should be treated as pass-through transactions. Conditions attached to a transfer could include provisions ensuring the existence and value of transferred cash flows at the date of transfer or conditions relating to the future performance of the asset. The Board indicated that such conditions would not affect whether the entity has transferred the contractual rights to receive cash flows (under paragraph 18(a)). However, the existence of conditions relating to the future performance of the asset might affect the conclusion related to the transfer of risks and rewards as well as the extent of any continuing involvement by the transferor in the transferred asset. The Board asked the staff to report its discussions to the IFRIC.

## Financial statement presentation

The Board continued its discussion of the application of the project's working principles in developing a 'working' format for the financial statements (the sections and categories for each financial statement).

The Board tentatively decided that treasury assets should be a separate category within the financing section (rather than within the business section as previously discussed). It also tentatively decided that some financial assets should be classified within the business section, but did not identify which assets. The Board tentatively decided that financing liabilities and treasury assets should be defined by function rather than by nature.

The Board tentatively decided that income taxes should be presented as a separate section in each of the financial statements (in addition to the business and financing sections). Income taxes related to transactions with owners should be recognised directly in equity instead of being recognised in the income taxes section in the statement of recognised income and expense. The Board also tentatively decided to modify the current disclosure requirements for income taxes to reflect changes in the presentation of those items.

The Board expressed its desire to work with the FASB on developing a common definition of 'discontinued operations'. The Board tentatively decided that, like income taxes, discontinued operations should be presented as a separate section in each of the financial statements. The Board also tentatively decided to retain the current disclosure requirements for discontinued operations in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* for the statement of financial position and the statement of recognised income and expense, but would eliminate the requirement in IFRS 5 to break down the cash flows related to the discontinued operation into their respective categories (operating and financing, for example).

The Board accepted the change of definition of the disaggregation working principle, which would now read as follows: 'Financial statements should present information in a manner that *disaggregates line items if that disaggregation enhances the usefulness of that information in predicting future cash flows*'. For disaggregation purposes, the financial statement presentation standard should require additional line items when such presentation is relevant to an understanding of an entity without including a 'bright-line rule' specifying the relative size of items required to be disclosed. Information should be presented on the statement of recognised income and expense by function and supplemental information on items that are important to understanding an entity's business should

be provided by nature either in the notes or in the financial statements. Information should be presented in the financial statements on a gross basis rather than net except when the additional information in a gross presentation provides no incremental value.

Having tentatively decided on a working format for the financial statements, the Board plans to revisit in October the definitions of financial liabilities, treasury assets and investments as well as discussing application of the remaining working principles, including subtotals, totals, and the reclassification (recycling) of items within the statement of recognised income and expense.

## Update on IFRIC activities

The staff reported on the September IFRIC meeting, details of which are available in *IFRIC Update*.

The IFRIC voted to recommend two Interpretations for approval by the Board: *Service Concession Arrangements* and *IFRS 2 Group and treasury share transactions*. The staff expects to bring both items for approval to the Board meeting in October.

Other items discussed by the IFRIC included two regarding revenue recognition, *Real Estate Sales* and *Recognition of Initial Fees*, and one addressing intangible assets, *Treatment of Catalogues and Other Advertising Costs*. The IFRIC also published six tentative decisions not to take issues onto its agenda. These are open for public comment for the usual 30-day period.

## IAS 24 Related Party Disclosures

The Board tentatively decided that when an entity qualifies as a related party of another entity simply because of the existence of common control from the State, IAS 24 should provide relief from the requirement to disclose related party transactions between those two commonly controlled entities. However, there are some situations in which disclosures should be made because of the nature of relationship that exists. The Board tentatively decided that IAS 24 should contain indicators that would require the relationship to be disclosed under IAS 24. The indicators would include:

- the existence of compulsion by the State for the entity to act in a particular way
- the existence of transactions at non-market rates between the two entities
- board members in common
- the use of shared resources
- economically significant transactions.

The Board tentatively decided that the entity should disclose that it is not aware of the existence of any indicators that would require the disclosure of other related party transactions.

The Board also tentatively decided to amend the definition of a related party transaction to remove the confusion over its translation and interpretation. The Board noted that the definition can be interpreted to mean transactions between two of an entity's related parties. The Board tentatively decided that the definition should be clarified to mean transactions between the entity and its related parties.

## Fair value measurement

The Fair Value Measurement project is included in the Memorandum of Understanding with the FASB and seeks to issue converged guidance on measuring fair value. The objective of the project is to define fair value more clearly and to provide guidance on measuring fair value when its use is required by another standard. The project is not intended to require additional fair value measurements or to increase the use of fair value in IFRSs.

The FASB has recently issued Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157), on which work was well advanced before the Memorandum of Understanding was issued. SFAS 157 establishes a single set of guidance for fair value measurements under US GAAP. The IASB recognised the need for consistent guidance on measuring fair value in IFRSs and for convergence with US GAAP. Consequently, the Board decided to use the FASB's Statement as the starting point for its deliberations. As the first stage of its project, the Board plans to publish a discussion paper on fair value measurement before the end of this year. The discussion paper will reproduce SFAS 157 with an invitation to comment that will set out the Board's preliminary views on the guidance in SFAS 157.

At this meeting the Board continued its discussions of the provisions of SFAS 157 and the issues and questions to be included in the invitation to comment.

### Length of the comment period

The Board discussed the length of the comment period for its proposed discussion paper. The Board recognises that, given the intended date of publication, the comment period will coincide with the reporting season for many companies. However, SFAS 157 is now available for interested parties to review and consider in advance of the discussion paper. Accordingly, the Board concluded that a 120-day comment period will be adequate for prospective respondents, who are encouraged to begin preparing for the discussion paper by examining SFAS 157.

### Non-performance risk

SFAS 157 states that the fair value of a liability should reflect the non-performance risk relating to that liability. Non-performance risk includes, but may not be limited to credit risk of the liability. IFRSs do not at present use the term 'non-performance risk'. However, IAS 39 requires the fair value of a financial liability to reflect the credit quality of the instrument. The Board observed that a requirement to consider non-performance risk when measuring the fair value of a liability extends the principle already established for financial liabilities in IAS 39 to fair value measurements of non-financial liabilities. The Board also observed that the risk that an obligation will not be satisfied affects the value at which that obligation is transferred. Therefore the Board reached a preliminary conclusion that the fair value of a liability should reflect the non-performance risk of that liability.

### Exit price definition of fair value

SFAS 157 defines fair value as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.' The Board directed the staff to include in the invitation to comment a discussion that highlights two points:

- The Board has not yet completed a standard-by-standard analysis to determine whether the exit price definition of fair value in SFAS 157 is consistent with the fair value measurement objective for every fair value measurement required in IFRSs. This analysis will be completed before preparation of an exposure draft, but likely after the comment period for the discussion paper has expired.
- If the Board concludes that a fair value measurement currently required by an IFRS is inconsistent with any revised definition of fair value, either that IFRS will be excluded from the scope of the fair value measurement exposure draft or the intended measurement objective will be communicated using a term other than fair value (such as 'current entry value').

Additionally, the Board decided to include in the invitation to comment a discussion reflecting the views of some Board members that the term 'fair value' encompasses not only an exit price measurement objective as defined by SFAS 157, but also an entry price measurement objective.

### Principal (or most advantageous) market

SFAS 157 indicates that a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The principal market is the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset. The most advantageous market is the market in which the reporting entity would sell the asset or transfer the liability with the price that maximises the amount that would be received for the asset or minimises the amount that would be paid to transfer the liability. The Board had previously indicated its preference for this concept over the guidance currently in IFRSs. Because this provision differs from the guidance in IFRSs, the Board directed the staff to include in the invitation to comment a discussion of the principal and most advantageous market guidance and the Board's preliminary views.

### Fair value measurements based on unobservable inputs

The Board observed that some might not regard a measurement based on unobservable inputs as an appropriate measure of fair value. Some believe that a measurement model cannot provide a reliable estimation of the fair value of an asset or liability if it depends significantly on entity-specific expectations that cannot be demonstrated to represent market expectations reliably. However, the Board decided that reliability is an issue that should be considered standard by standard and is not an attribute of the definition of fair value. As such, the Board decided not to include a discussion of the reliability of fair value measurements within the invitation to comment.

### Block premiums and discounts

SFAS 157 states 'If the reporting entity holds a position in a single financial instrument (including a block) and the instrument is traded in an active market, the fair value of the position shall be measured within Level 1 as the product of the quoted price for the individual instrument times the quantity held.' The Board expressed concern that this guidance could be read as allowing an entity to choose a lower level fair value measurement (ie Level 2 or Level 3) that includes a blockage factor in lieu of a Level 1 price in an active market. The Board indicated that, although it agreed with the concept, the wording should clearly state that whenever a price in an active market is available for a financial instrument measured at fair value, the

fair value should be determined on the basis of that price times the quantity held.

### Day one gains and losses

SFAS 157 provides guidance on measuring fair value at initial recognition that differs from the guidance in IAS 39. The Board reaffirmed its previous decision to include a discussion of the differences between the guidance in SFAS 157 and IAS 39 without including a preliminary view on this issue.

### Highlighting or deleting US GAAP-specific information in the discussion paper

The Board observed that SFAS 157 includes an appendix that lists US GAAP pronouncements that refer to fair value (Appendix D) as well as an appendix containing amendments to US GAAP pronouncements (Appendix E). The Board decided not to reproduce these appendices in the discussion paper because they would not be relevant to IFRSs. The Board decided not to make any other modifications to or deletions from the text of SFAS 157.

### Publication of the discussion paper

Pending the satisfactory resolution of some outstanding comments on the draft invitation to comment, the Board authorised the publication of the discussion paper subject to completion of the balloting process.

## IFRS 1 amendments

### Cost of investment

At its meeting in March, the Board added a project to its technical agenda to resolve issues relating to difficulties in restating the cost of an investment in a subsidiary in the separate financial statements of a parent on first time adoption of IFRSs.

At this meeting, the Board discussed potential amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* to provide relief from restating cost in accordance with IAS 27 *Consolidated and Separate Financial Statements* on transition to IFRSs.

The Board tentatively decided to amend IFRS 1 to allow a parent to use either

- the carrying amount of the net assets of a subsidiary (in accordance with IFRSs) or
- the fair value of a subsidiary at the date of the parent's transition to IFRSs

as its deemed cost in the separate financial statements of the parent on transition to IFRSs.

### Post-transition distributions

The cost method in IAS 27 states that 'investors receive income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition'. In order to determine whether distributions are from the accumulated profits arising after the date of acquisition, a parent would be required to restate the pre-acquisition accumulated profits under IFRSs for all subsidiaries acquired before the parent's transition to IFRSs.

The Board tentatively decided to provide relief from these requirements so that:

- if a parent applies the relief from restating the cost of an investment in a subsidiary in accordance with IAS 27 on transition to IFRSs, all accumulated profits of the subsidiary at that date are deemed to be pre-acquisition profits for the purposes of applying the cost method in IAS 27 subsequently.

- if a parent does not use the relief from restating the cost of an investment in a subsidiary in accordance with IAS 27 on transition to IFRSs, the pre-acquisition accumulated profits of the subsidiary under the previous national GAAP at that date are deemed to be the pre-acquisition profits for the purpose of applying IAS 27.

## Technical plan

The Board made its quarterly review of its Technical Plan. The Plan sets out the expected timetable over the coming 18-24 months for projects on the IASB's active agenda. The Board publishes the revised timetable on its Website following each review. Updated projects summaries are available on the IASB Website at <http://www.iasb.org/current/iasbworkplan.asp>.

### 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

16—20 October  
23—24 October (joint with FASB), Norwalk, Connecticut, USA  
13—17 November  
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  
16—21 September  
15—19 October  
22—24 October (joint with FASB), Norwalk, Connecticut, USA  
12—16 November  
10—14 December