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SAC MEETING
NOVEMBER 2006

**Minutes of the Meeting of the
Standards Advisory Council
held in London on 9 and 10 November 2006**

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SAC Members:

Attending:

Adir Inbar	Patrice Marteau
Alberto Giussani	Piotr Madziar (official EC observer)
Anna di Michele	PM Kam
Arnold Schilder (Basel Committee)	Richard Thorpe (CESR)
Benoit Atangana Onana	Rifaat Karim (9 November)
Christoph Ernst (IOSCO representative)	Sarah Deans
Darrel Scott	Shamim Diouman (IAIS)
David Lindsell	Toshihiro Horitomo (Translator for Mr. Yagi)
Eiko Tsujiyama	Trevor Harris
Hector Vela	Vladimir Preobrazhenskiy
Heinz-Joachim Neubürger	Yoshiki Yagi
Hiroyuki Hara (Assisting official FSAJ observer)	
Hugo Schaub	Apologies:
Ingebret Hisdal	Charles McDonough (World Bank)
Jochen Pape	Colleen Cunningham
John Carchrae (IOSCO representative)	Danny Teoh
Jose Antonio Alvarez (9 November)	Frank Brod
Judith Downes	Hector Estruga
Julie Erhardt (official SEC observer)	Ian Ball (IFAC)
Junichi Maruyama (Official FSAJ observer)	Jun Wang
Kees Storm	Pat McConnell
Kenneth Sullivan (IMF)	Shailesh Haribhakti
Mauro Grande	Suk-Jun Lee
Nelson Carvalho, <i>Chairman</i>	Tatiana Krylova (UNCTAD)

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IASCF Trustees:

Sir Bryan Nicholson, Jens Røder, and Malcolm Knight (9 November)

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IASB Members:

Sir David Tweedie, <i>Chairman</i>	Patricia L. O'Malley
Anthony T. Cope	Philippe Danjou
Jan Engström	Robert Garnett
John T. Smith	Tatsumi Yamada
Mary Barth	Warren McGregor

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IASB and IASC Foundation Staff:

Liz Hickey, Director of Technical Activities

Tom Seidenstein, Director of Operations IASCF

Wayne Upton, Director of Research

IASB Technical Staff and IASC Foundation Staff

1 Opening Remarks

Welcome

- 1.1 The SAC Chairman, Nelson Carvalho, welcomed participants to the meeting. He also welcomed Ms. Terri Polley from the FASB's Financial Accounting Standards Advisory Council (FASAC); Shamim Diouman from the International Association of Insurance Supervisors (IAIS); Pamela O'Connell from the World Bank; Richard Thorpe from the Committee of European Securities Regulator (CESR); and Georgene Palacky from the CFA Institute. Mr. Carvalho noted that from the next meeting Ms. Silvie Matherat would be replacing Mr. Arnold Schilder as the representative of the Basel Committee.

Introductory Remarks by IASC Foundation Trustees'

- 1.2 Sir Bryan Nicholson, an IASC Foundation Trustee, introduced himself to SAC members by explaining his past experience with standard setting issues.
- 1.3 Sir Bryan commented on the progress the IASB has made since its creation in 2001. With more than 100 countries applying IFRSs around the world, he expected that a total of 150 countries would be applying IFRSs in the near future. Sir Bryan described the US convergence project as sensible with a commitment from both sides to make it work. Further, he noted the significance of the appointment of a Chinese national to join the IASB in mid 2007. Sir Bryan concluded by stating that significant progress has been achieved in securing a diversified and broadening financing base from 2008 onwards.
- 1.4 Jens Røder, an IASC Foundation Trustee, commented on the newly created framework to guide and evaluate the effectiveness of the Trustees' oversight function. He added that in undertaking this exercise, the Trustees had agreed that oversight effectiveness is an integral part of the wider concept of Trustees' accountability. To that end he observed that it was essential that Trustees, individually or as a whole, are engaged formally and are deliberate in their oversight of the organisation.
- 1.5 In order to exercise an effective oversight role, Mr. Røder observed that the Trustees required a more formal interface not only with the IASB, but also with the SAC and IFRIC. He argued that such interaction required a flow of information from the IASB, IFRIC and SAC in order to enable the Trustees to reach conclusions as to whether performance criteria were being met, consultation was occurring, and external views were being considered appropriately. Mr. Røder encouraged SAC members to comment on how to improve the proposed oversight framework of the IASC Foundation.

2 Discussion of IASC Foundation Initiatives

- 2.1 Ken Creighton, IASC Foundation Senior Manager - Publications, reported on the initiatives undertaken to disseminate materials in print and electronic format.
- 2.2 He noted that publication activities supported IFRS adoption by enabling governments and standard setters to access and provide core IFRS without barriers. The Foundation maintained consistent and transparent terms for all licensing and commercial activities that include a range of discounts based on a country's income level. The publication proceeds provided approximately 20 per cent of the total cost of standard setting.

- 2.3 Mr. Creighton noted that translation activities were designed to create and maintain only one high-quality translation per language for international use. The existing platform was an integral part of a consistent process involving expert review and covering more than 40 languages. At the core of the process was the maintenance and enforcement of copyright to ensure the global integrity and consistency of IFRS. He also noted that products available on the IASB Website included comprehensive subscription (all print and electronic material), eIFRS, CD ROMs, educational material, and the 2007 English Bound Volume which was expected to be published in March 2007.

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- 2.4 Several members indicated that in certain circumstances translated text does not always capture the intended meaning of the English text. Members expressed concern that such a discrepancy might lead to a dispute and divergence in the application of IFRS. Thus, they suggested that the translated text was recognised but that it should specify that in cases of differences the English text prevailed.
- 2.5 One member noted a drawback of the translation process, commenting that it took more than one year to have a translation in place. In light of the potential discrepancies that might arise in the translation process, this member suggested that a dictionary should be made available outlining the various possibilities of interpretations across languages.
- 2.6 Because of the scope of the SME project, some members observed that the project would require more translations. By way of example, one member noted the existence of 11 official languages in South Africa. Another member commented that the translation of the SME project would give rise to some legal issues particularly if a jurisdiction allowed a large entity to apply IFRSs for SMEs. They added that such an occurrence would represent an additional threat to IFRSs as a brand.
- 2.7 Mr. Creighton confirmed that the Exposure Draft of the IFRS for SME would be translated into different languages, the first time that such a due process document had been translated. He explained that translations were approved by a review committee composed of diverse and distinguished professionals whose remit was to ensure that translated text was widely understood in the translated language. He acknowledged that the translations took time but added that time was necessary for quality control purposes. Mr. Creighton supported the suggestion of a translation dictionary.

3 Views on the Strategic Direction of Financial Reporting

- 3.1 Georgene Palacky, on behalf of the Centre for Financial Market Integrity of the CFA Institute and in place of SAC member Pat McConnell, presented the remaining part of the CFA Institute paper, "A Comprehensive Business Reporting Model: Financial Reporting for Investors" which had been presented at the June SAC meeting. Her presentation covered a revision to Principle 1 and a discussion of the four principles not covered at the June meeting. The CFA Institute planned to issue the paper in of December 2006.
- 3.2 Principle 1 originally stated that "the company must be viewed from the perspective of a current investor in the company's common equity". Ms. Palacky explained that Principle 1 had been revised to clarify the position of the reporting entity and primary purpose of financial statements. As a result of that revision, Principle 1 had been divided into two principles.

- 3.3 The revised Principle 1 stated that “the objective of financial reporting is to provide the information needed by current and potential claimants against a company (including equity investors, creditors, and others) in investment and other resource allocation decisions”. Ms. Palacky noted that revised Principle 1 met the information needs of claimants who could not otherwise command financial information.
- 3.4 The revised Principle 2 stated that “A company’s transactions and the events that affect it are reported from the perspective of the last residual claimant – typically a current shareholder”. Ms. Palacky observed that revised Principle 2 defined the reporting entity and level of consolidation of financial reporting that should be provided. She also added that this principle simplified the definition of liabilities vis-à-vis equity by ranking claims in order of priorities.
- 3.5 Ms. Palacky indicated that an international study titled *Identifying Decision useful Information with the Matrix Format Income Statement* is underway. The aim of the study was to assess the usefulness of the matrix format and how such a format could provide greater clarity in relation to re-measurements. She observed that the Centre’s preliminary conclusion was that the matrix format improves transparency as it provided information relating to ‘below-the-line’ items.
- 3.6 Describing Principle 12 as disclosures that provided the economic context for the financial statement, Ms. Palacky noted that disclosures should provide sufficient information to enable users to understand accounting policies, events and transactions, operation and activities as well as financial risk. She emphasised that disclosures were not a substitute for recognition and measurement.
- 3.7 Noting that the reporting of disaggregated information was the focus of Principle 10, Ms. Palacky argued the need for better segment reporting. Two surveys conducted by the Centre had revealed a gap between the information needed by analysts and that provided by preparers.
- 3.8 Principles 5 and 6 addressed issues of Materiality and Neutrality of Financial Information respectively. Ms. Palacky explained that the principle of materiality was based on whether the information made a difference to the primary users of financial statements. Ms. Palacky noted that to comply with the principle of neutrality accounting should be based on the method that best captured the economic substance of an item or event, and not the form of the transaction or its outcome.

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- 3.9 Some members questioned why the CFA Institute’s paper was on the agenda given that it had been discussed at the June SAC meeting and the Institute expected to publish the paper in December. At the June meeting these members had disagreed with many aspects of the paper’s proposals. Further, members questioned the application of those proposals to the IASB work plan. The Chairman noted that in June SAC took the decision to schedule for the November 2006 meeting the completion of the debate on the paper.
- 3.10 Several members commented that the comprehensive reporting model risked providing less information than it intended. Those members argued that the purpose of accounting was not to produce endless amount of information but rather to produce relevant information. Thus, they suggested the adoption of a “back to basics” approach to determine the information that needed to be provided. Another member added that a company’s financial reporting department would be unable to cope with additional reporting requirements as they were at full capacity with

existing requirements. The members noted that the IASB was aware of this and had announced that no more IFRSs would be effective until 2009. Members also stated that additional requirements would increase the cost of compliance as such information would need to be audited. Given these concerns, some members indicated that the CFA's views need to be balanced.

- 3.11 Other members noted that the CFA paper was not representative of all analysts' views. They commented that analysts were diverse in their informational requirements. For example, some did not view a measure of fair value as priority, whilst others omitted measures of cash flows. One member recommended that for new IFRSs, the IASB should include in the Basis for Conclusions an analysis on how the IFRS would facilitate an improvement in the assessment of risk and return.
- 3.12 Some members welcomed the CFA's proposal on the grounds that the current format was far from satisfactory. By way of example, a member noted that at present more than 3,000 items were required to be disclosed in financial reports, and suggested that disclosures were necessary due to the limitations of accounting. Another member agreed with the matrix presentation in the CFA paper but added that net income was more important for investors in the decision making process.
- 3.13 Ms. Palacky responded that the CFA sought information that was informative, some of which was available in electronic format such as Extensible Business Reporting Language (XBRL). She explained that users requested different information because of accounting options that companies had at their disposal. The expectation was that information would be provided to enable users to compare companies. She noted that the benefits of new information requirements were often difficult to determine but observed that investors ultimately paid the cost. Nonetheless investors derived a benefit in that they gained a better understanding of the company.
- 3.14 Sir David Tweedie, IASB Chairman, and Nelson Carvalho, SAC Chairman, thanked Ms. Palacky for the CFA's contribution to the financial reporting debate. Sir David commented that the paper's proposals were relevant to the IASB's Conceptual Framework and Presentation of Financial Statements projects.

4 Discussion of IASB Work Plan

- 4.1 Sir David Tweedie, IASB Chairman, outlined the three main strategic objectives of the IASB:
 - (a) completion of a standard for SMEs;
 - (b) encouraging more countries to switch to IFRS rather than use national standards; and
 - (c) convergence of IFRS and US GAAP .
- 4.2 In speaking about the first objective, Sir David commented that the Board had continued its deliberation of the draft Exposure Draft (ED) of an IFRS for SMEs with a view to publishing the ED at the beginning of 2007. He added that the publication of the ED represented a milestone in a detailed process that reflected input from constituents who had commented on the Discussion Paper, a questionnaire on recognition and measurement, a round table, working group meetings, and SAC meetings. Sir David commented that a major part of the Board's debate has centred on the extent to which mandatory fallback should be required, a route the Board is trying to avoid.

- 4.3 Sir David noted that the Board had announced a number of initiatives to encourage adoption of IFRS, which would enable more countries to switch to IFRS. These initiatives included increasing the lead time to prepare for new standards, holding round-tables on key topics including conceptual and measurement issues and deferring the effective date of new IFRSs until 2009.
- 4.4 Sir David noted that the convergence programme fulfilled the IASB commitment towards the removal of the requirement for overseas registrants to reconcile their financial statement to US GAAP, and the eventual existence of one set of high-quality global accounting standards. He added that the removal of the reconciliation requirement depended upon the efforts and actions of many parties. The joint work with the FASB was designed to ensure that the answers produced by IFRS and US GAAP would be substantially the same once the programme set out in the Memorandum of Understanding (MoU) between the IASB and the FASB was completed. Accordingly, a significant part of the Board's work was centred on the requirements specified in its MoU with the FASB.
- 4.5 Elizabeth Hickey, IASB Director of Technical Activities, commented that the draft ED on IFRS for SME had been posted on the website to enable constituents to follow the draft's proposals and developments. She explained that the IFRS was designed for companies employing 50 employees but each jurisdiction ultimately would decide to whom the IFRS should apply.

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- 4.6 Some members acknowledged that, although progress on the SME project had been made, a gap persisted because the draft ED was not a stand alone document. Members asked whether the Board was considering further simplification and questioned the significance of the SME standard to local GAAP.
- 4.7 IASB members and staff responded that the Board expected the SME standard to be a stand-alone document. A Board member added that the document would not require a mandatory fallback to the full IFRS. In case of uncertainty a hierarchy was in place that analogised to the full IFRS. This Board member observed that a balance needed to be made in keeping the IFRS short whilst providing self-sufficient guidance. Another Board member emphasised that individual countries would decide whether to adopt the standard for SMEs and the impact of that standard on local GAAP. IASB staff explained that further simplification in deferred tax, pensions and financial instruments would be considered.
- 4.8 In light of the Board's decision to issue SFAS 157 *Fair Value Measurements* as a Discussion Paper (DP) and not an ED, a SAC member asked the Board whether such a decision would have an effect on convergence. This member also asked whether the IASB had an option to depart from SFAS 157 given the need for convergence.
- 4.9 IASB staff indicated that the IASB had decided on a DP because SFAS 157 was designed for developed and not emerging economies. Further, given the level of confusion with the term fair value, the IASB decided to give its constituents more opportunities to comment. The Board and the staff acknowledged that a potential disagreement on convergence project between the two boards would be a cause of concern.
- 4.10 Several SAC members noted that the distinction between equity and liabilities was not just a matter for companies. They observed that the solution should consider notions of equity under the law. The staff expressed concern with the suggestion of

relying on legal aspects of equity because such aspects were not considered in the ED.

- 4.11 A member commented that mixed views around the world had been expressed on convergence. He stated that whilst some companies fully supported the Board's work on convergence, others have recommended not seeking convergence at any cost. The reason was that IFRS were principles-based and US GAAP were rules-based. In their view this created a significant conceptual difference.
- 4.12 IASB members and staff noted that convergence focused on major differences. They emphasised that both the FASB and IASB agreed on writing principles-based standards and often debated whether guidance was necessary to clarify a principle. For the new standard on lease accounting, an IASB Board member had agreed to draft a principle-based mock up based on the G4+1 papers, so that auditors could determine whether that standard could be audited. If the principles-based mock up could be audited, the Board would discuss it with the regulators.
- 4.13 One member expressed concern with the lack of progress on the Financial Statement Presentation project. He noted that this project had been on the active agenda since 2001. Another member expressed concerns with delays on the Insurance project.
- 4.14 IASB staff responded that Phase B of the Financial Statement Presentation project was the beginning of a long process. A DP was envisaged for 2007 followed by an appropriate comment period for constituents to express their views and IASB staff to analyse comments and present proposals to the Board. The staff also explained that in light of the complexities of the Insurance project, additional time had been required for further debate. Nonetheless, the Board expected to issue a DP in the first quarter of 2007.

5 Liabilities and Equity

- 5.1 Wayne Upton, IASB Director of Research, and Caron Hughes, IASB staff, presented an overview of the Liabilities and Equity project. Describing the project as a modified joint project with the FASB, Mr. Upton explained that such a project involved one board initially using the work of the other and issuing it as a DP. The two boards worked jointly from the point where a due process document was published. Since the FASB was about to publish its preliminary views on Liabilities and Equity, the presentation to the SAC was a high-level overview of the FASB position.
- 5.2 Ms. Hughes explained that the objective of the project was to develop a comprehensive standard because issues had been encountered with existing guidance under IAS 32 *Financial Instruments: Presentation*. She added that this was an area of accounting that was innately controversial and pervasive in nature.
- 5.3 The FASB was contemplating three models: (a) Ownership – Settlement; (b) Ownership – comprising of a narrow view of equity; and (c) Re-assessed Expected Outcome (REO). In all three models focus was on identifying equity as opposed to identifying liabilities. The presentation included three examples that illustrated the accounting under the different models.
- 5.4 Since the FASB was scheduled to issue a preliminary views document in the first half of 2007, the IASB was expected to issue that FASB document as a DP shortly after that date. The Liabilities and Equity project would subsequently become a joint project.

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- 5.5 Members were asked which of the models had the highest likelihood of success in achieving the project's objectives. Some of the views expressed were as follows:
- (a) A member stated that the ownership model could be classified as a liability. This member concluded that the CFA paper was consistent with the ownership approach.
 - (b) A member observed that the more rules about equity and liability classifications that were in place, the more financial instruments were created to avoid those rules. This member recommended that the Board adopted a high level principle approach in revising the current standard.
 - (c) A member questioned whether classification should be assessed from the perspective of the shareholder or the entity.
 - (d) A member expressed support for an approach that considered the legal position of equity.
 - (e) A member cautioned that the REO model would lead to a new and large range of opportunities for the creation of new financial instruments in the investment banking industry since that model was complex and permitted many alternative interpretations and structuring.
 - (f) A member noted the importance of constituents understanding the outcome. In the case of Australia, it was stated that unit trusts had no equity at all under current IAS 32. Although that was an uncomfortable outcome, this member argued that a new industry would not proliferate since the process was clear and simple.
 - (g) A member expressed support for the ownership approach, noting that a similar model was applied in Japan.
- 5.6 IASB members and staff commented that IAS 32 and the Ownership model had a clear principle but acknowledged that such principle sometimes produced counter-intuitive results. A Board member noted that the project should be viewed as a search for the principle which would be valuable for the Conceptual Framework team. This Board member added that although REO created complexities, the ownership model and REO were less likely to create opportunities for structuring.
- 5.7 Members were asked to share their views on the relative importance of the project as compared with other topics on the research agenda. Some of the views expressed were as follows:
- (a) Some members stated that it was not a priority because constituents were learning to live with IAS 32.
 - (b) Several members commented that the project was of significant importance.
 - (c) Others expressed difficulty in reaching a view given the complexity of the topic.
- 5.8 In light of FASB's issuance of SFAS 157 and the forthcoming preliminary views paper on Equity and Liability, a SAC member noted that such publications might lead to divergence as those proposals would take longer to filter through the EU. Another member asked whether differences between full IFRSs and IFRS for SMEs would lead to inconsistency in the application of both standards.

- 5.9 IASB members and staff commented that the DP on Liabilities and Equity should be regarded as the first step in the process towards a potential standard. If, however, public reaction was negative, priority could be given to other projects. Several Board members reiterated that convergence was driving the IASB agenda and as such the FASB work would have an impact on the work of the IASB. IASB staff noted that a question on how often to update IFRS for SMEs resulting from other developments in full IFRS would be included in the ED.

6 Fair Value Measurement

- 6.1 Jon Nelson, IASB Practice Fellow, updated members on the status of the Fair Value Measurement project. By way of background, Mr. Nelson commented that the project had been added to the IASB agenda in September 2005. The project was part of the MoU and was intended to codify and simplify guidance for fair value measurements in IFRS.
- 6.2 Mr. Nelson explained that a standard on fair value was necessary because use of fair value was not always consistent in IFRSs. He commented that the FASB recently issued Statement of Financial Accounting Standard No. 157 (SFAS 157) which the IASB planned to issue as a DP. The Board would consider comments on the DP in developing an ED on Fair Value Measurements. The final IFRS was expected in late 2008 or early 2009. He added that some of the differences identified between IFRSs and SFAS 157 included definition of fair value, day-one gains, measuring fair value when inputs were based on bid and asked prices and determining the market on which a fair value measurement should be based.

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- 6.3 Members divided into groups to consider the following three questions on the fair value project:
- (a) The implications of divergence should the IASB reach different conclusions from the FASB;
 - (b) The specific implications of divergence on the usability of financial statements, and the cost of compliance for companies that must reconcile or for those that report under IFRS and US GAAP; and
 - (c) The factors that SAC members would consider in balancing convergence with differing views on how fair value should be defined and measured.
- 6.4 Group 1 commented that high quality should be the driver and not the cost. In the case of divergence they expected a dialogue with the relevant partners but ultimately preferred the best solution even if that created divergence with SFAS 157. They recommended an approach where divergence could be managed as opposed to compromise.
- 6.5 Given the differences in publication date between SFAS 157 and an equivalent IFRS, Group 2 anticipated difficulties. This group expressed concern with the day-one gain and SFAS 157 definition of fair value. They suggested that IASB raised its concerns with the FASB so that potential differences could be eliminated.
- 6.6 Group 3 noted that divergence could affect the removal of the reconciliation requirement and therefore recommended that an agreement should be reached on SFAS 157. They commented that fair value measurement should not be sacrificed as a result of convergence, but rather there should be a balance between the two. The

group expressed concern with the potential impact that divergence would create in other IFRSs such as Business Combinations.

- 6.7 A member commented that the Board made the right decision in issuing SFAS 157 as a DP. He noted the importance of having guidance but not necessarily based on SFAS 157 as there were many issues to be resolved. IASB staff responded that members' feedback was appreciated and would assist staff in making future recommendations on the project.

7 Implementation/interpretation/national standard setters

- 7.1 Mr. Carvalho commented on the risks related to the application of IFRSs around the world. He identified issues on the auditing of principle-based standards, global compliance of IFRS, the interpretation model of IFRIC and the availability of resources for the IASB. He asked members to reflect whether the IFRIC model fulfilled the requirement of the IFRS platform given the need for guidance, training, education and interaction with the legal framework. He also asked members to reflect whether the IASB should have more staff or less projects on its agenda. Because of time constraints and due to the relevance of the topic, members agreed to the SAC Chairman's proposal to postpone this discussion to the February meeting.

END