

**Minutes of the Meeting of the  
Standards Advisory Council  
held in London on 25 and 26 June 2007**

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*SAC Members:*

**Attending:**

Adir Inbar  
Alberto Giussani  
Anna di Michele  
Benoît Atangana Onana  
Charles McDonough (World Bank)  
Christoph Ernst (IOSCO representative)  
Darrel Scott  
David Lindsell  
Eiko Tsujiyama  
Heinz-Joachim Neubürger  
Henning Göbel (IAIS)  
Hiroyuki Hara (Assisting FSAJ observer)  
Hugo Schaub [25 June only]  
Ian Ball (IFAC) [25 June only]  
Ingebret Hisdal  
Jochen Pape  
John Carchrae (IOSCO representative)  
Judith Downes  
Julie Erhardt (official SEC observer)  
Junichi Maruyama (FSAJ observer)  
Kenneth Sullivan (IMF)  
Michael Cangemi  
Mauro Grande [25 June only]  
Nelson Carvalho, *Chairman*  
Patrice Marteau

Piotr Madziar (official EC observer)  
PM Kam  
Richard Thorpe (CESR representative)  
Rifaat Karim  
Robert Morgan  
Sarah Deans  
Shailesh Haribhakti  
Sylvie Matherat (Basel Committee)  
Toshihiro Horitomo (Asst. to Mr. Yagi)  
Yoseph Asmelash (UNCTAD)

**Apologies:**

Danny Teoh  
Frank Brod  
Hector Estruga  
Hector Vela  
Jose Antonio Alvarez  
Wang Jun  
Suk-Jun Lee  
Trevor Harris  
Vladimir Preobrazhenskiy  
Yoshiki Yagi

\* \* \*

*IASCF Trustees:*

None

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*IASB Members:*

Sir David Tweedie, *Chairman*  
Anthony T. Cope  
Gilbert Gélard  
Hans-Georg Bruns  
Jan Engström  
Mary Barth

Patricia L. O'Malley  
Philippe Danjou  
Tatsumi Yamada  
Tom Jones  
Warren McGregor

\* \* \*

*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

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*Other Guests:*

Dennis Chookaszian (FASAC)  
Ian Hague (CICA staff)  
David Loweth (UK ASB staff)  
Terri Polley (FASAC)  
Rebecca Villmann (CICA staff)

## 1 Opening Remarks

### Welcome

- 1.1 The SAC Chairman, Nelson Carvalho, welcomed participants to the meeting. He introduced Yoseph Asmelash, new member to the SAC. Mr. Asmelash is the Economic Affairs Officer in the Investment and Enterprise Competitiveness Branch of the Division on Investment, Technology and Enterprise Development of the United Nations Conference on Trade and Development (UNCTAD). Mr. Carvalho also welcomed Ms. Terri Polley from the FASB's Financial Accounting Standards Advisory Council (FASAC). He thanked the SAC's Agenda Committee for their work in organizing the June 2007 meeting and reminded the SAC members of the second annual IFRS conference to be held in Singapore from 29–30 August 2007.

### Announcements

- 1.2 Mr. Carvalho announced that Darrel Scott, Financial Officer at FirstRand Bank Limited, is stepping down from his role as a SAC member and moving on to join the IFRIC. He thanked Mr. Scott for his contribution to the SAC.
- 1.3 Sir David Tweedie, IASB Chairman, announced that this was the final SAC meeting for the IASB's three retiring Board members: Patricia O'Malley, Hans-Georg Bruns, and Tony Cope. He indicated that Ms. O'Malley would be remaining with the IASB in the capacity of IFRIC coordinator. Sir David also introduced the IASB's newest Board member, Zhang Wei-Guo. Mr. Zhang is from China and is scheduled to officially join the Board as of 1 July 2007.

### Introductory Remarks by IASC Foundation Trustees

- 1.4 Tom Seidenstein, IASCF Director of Operations, spoke to the members on behalf of the IASC Foundation Trustees. Mr. Seidenstein explained that none of the IASCF Trustees were in attendance due to conflicting meeting schedules.
- 1.5 Mr. Seidenstein began with an update regarding the Trustees' strategy for furthering the objectives of the organisation. He indicated that the Trustees are focused on creating a general vision of where they believe the organisation will be in the next ten years. The Trustees will be consulting SAC as to how this strategy may be operationalised. The Trustees plan to consult with the SAC's Small Committee sometime in September or October; committee members will be given the opportunity to present preliminary views on this topic. Mr. Seidenstein indicated that this initial work would set the stage for the organisation's constitutional review in 2008.
- 1.6 Mr. Seidenstein advised the SAC members of the Trustees' meeting to be held in Madrid the following week, 2–3 July 2007. One item to be discussed at the meeting is the oversight measures that were put in place after the April Trustees' meeting. Additional topics to be considered include the following:
- progress made by the IASB in developing a framework for the Feedback Statement;
  - how the IASB takes into account cost/benefit considerations when developing accounting standards;
  - an update of the IASB's work programme;

- progress made toward the long-term financing initiative of achieving a £16M budget for 2008 for standard setting activities; and
- the need to develop a funding system comprised of a broader participant base.

## 2 Conceptual Framework

- 2.1 The discussion on the conceptual framework project was divided into two parts: an update of the project and a breakout session focused on the concept of *stewardship*.

### Project Update

- 2.2 Ian Hague, AcSB Principal, and Li Li Lian, IASB Project Manager, updated members on the status of each active phase of the conceptual framework project. Mr. Hague reminded the members that four phases of the conceptual framework project are currently active: 1) objectives and qualitative characteristics; 2) elements and recognition; 3) measurement; and 4) reporting entity.

### Objectives and Qualitative Characteristics

- 2.3 Mr. Hague indicated that this phase of the conceptual framework project is at a more advanced stage than the other phases. A discussion paper for this phase was issued in November 2006; the Boards' redeliberations of the issues presented in the discussion paper are ongoing. The staff expects to issue an exposure draft in the fourth quarter of 2007.
- 2.4 The Boards have tentatively decided to retain *faithful representation* as a replacement for *reliability* in the qualitative characteristics of financial reporting. Faithful representation includes the concepts of *neutrality* and *completeness* however it does not include the concept of *conservatism*. Faithful representation reflects the economic substance of a transaction, regardless of its form.
- 2.5 The redeliberations have also resulted in a repositioning of the qualitative characteristics in relationship to one another. The discussion paper outlined four key qualitative characteristics (relevance, faithful representation, understandability, and comparability) coupled with two constraints (materiality and cost/benefits). The Boards have determined that some of the previously identified qualitative characteristics are really enhancing characteristics.
- 2.6 The Boards have tentatively determined that relevance and faithful representation are the primary qualitative characteristics with understandability and comparability functioning as enhancing qualitative characteristics. *Verifiability*, which had previously been considered a sub characteristic of faithful representation, will now be cast as a characteristic that enhances faithful representation. *Timeliness*, which had previously been characterised as a component of relevance, will be classified as a general enhancing characteristic because it can affect both relevance and faithful representation.
- 2.7 Mr. Hague summarised the relationship of each of the qualitative characteristics to one another in the following way: relevance and faithful representation are the two primary qualitative characteristics; they are supported by comparability, understandability, verifiability, and timeliness as enhancing qualitative characteristics. The two constraints of materiality and cost/benefits remain intact.

- 2.8 Mr. Hague moved on to discuss respondents' comments regarding the objective of financial reporting as it was articulated in the discussion paper. Many respondents questioned whether the discussion of *objective* should be limited to financial statements versus the entirety of financial reporting. Mr. Hague indicated that the Boards tentatively concluded that objective, as it is used in the conceptual framework, should refer to all financial reporting, not merely the financial statements.
- 2.9 Mr. Hague noted that phase E of the conceptual framework project addresses financial reporting. Topics to be covered in this stage of the project include determining what financial reporting encompasses as well as an exploration of what the boundaries of financial reporting may be.
- 2.10 Mr. Hague indicated that the Boards affirmed the position taken in the discussion paper that the primary user group is present and potential investors and creditors.

#### Elements and Recognition

- 2.11 Mr. Hague said that the staff expects to report back to the Boards at the July meeting on the results of its consultations with various third parties regarding the definition of an asset.
- 2.12 Mr. Hague indicated that work had continued on refining the definition of a liability, in conjunction with the staff of the IAS 37 project. Much of the discussion had focused on distinguishing between a business risk and a liability and how the concept of uncertainty should be incorporated in any definition of a liability.
- 2.13 Further work in the conceptual framework project on the distinction between liabilities and equity has been temporarily suspended pending the issuance of the discussion paper associated with the standards level guidance on liabilities and equity. Constituent feedback on that discussion paper will be useful in considering the distinction between liability and equity from a conceptual framework perspective.
- 2.14 The staff anticipates issuance of a discussion paper for this phase of the conceptual framework project towards the end of the second half of 2008.

#### Measurement

- 2.15 Mr. Hague described the three milestones of the measurement project:
- catalogue, define, and describe the different bases of measurement;
  - evaluate the different bases of measurement by reference to the qualitative characteristics; and
  - derive conclusions about each measurement base's place in the conceptual framework.
- 2.16 Roundtables on measurement were held earlier this year. The Boards have considered the feedback received on this topic.
- 2.17 Mr. Hague indicated that when the staff surveyed the accounting literature in use today it found twenty-seven different measurement bases. To simplify, the staff grouped them into nine prime categories distinguished by the following common general characteristics:
- Past entry price
  - Modified past entry amount
  - Past exit price
  - Current entry price

- Current exit price
- Current equilibrium price
- Value in use
- Future entry price
- Future exit price

2.18 The staff intends to issue a document summarising the analysis of milestone one issues in July 2007.

#### Reporting Entity

2.19 The discussion paper (preliminary views document) on this phase of the conceptual framework project is currently being drafted and should be ready for issuance by the end of the third quarter of 2007.

2.20 The focus of the discussion paper will be on determining the boundaries of the reporting entity for both the individual entity and a group of entities. The Boards have concluded that a reporting entity is comprised of a circumscribed area of economic interest to external users of financial reports. A circumscribed area is not necessarily defined in legal terms, although in some cases it may be.

2.21 The mechanism by which companies should be considered together is to be based on one entity having control over another entity. The concept of control will include the notions of the controlling company having power over the controlled entity and the controlling company being able to extract benefits from the controlled entity.

2.22 A group reporting entity is typically viewed as comprising a single parent with all of the entities under its control. The Boards have also concluded that general purpose external financial reports (GPEFR) may also be prepared for entities under common control that collectively are a circumscribed area of economic interest for external users of financial statements.

2.23 The Boards concluded that a parent entity must provide consolidated financial statements that present information about all of the assets, liabilities and activities of the parent and its subsidiaries. The FASB Board decided not to require parent only financial statements as a GPEFR; the IASB Board has yet to reach a conclusion on parent only financial statements. Some IASB Board members support the view taken by the FASB while others believe that both consolidated and parent only financial statements should comprise GPEFR.

#### Open Forum

2.24 Some members indicated their belief that the objective of conservatism was something that has been discarded early on in the conceptual framework project. These members wanted to know the extent to which the Boards are willing to revisit conservatism, especially in light of the problems currently facing investors in the US sub-prime mortgage market.

2.25 Warren McGregor, IASB Board Member, responded that the Boards' view on conservatism does not suggest that preparers of financial statements shouldn't be careful. What the Boards are really saying is that financial reporting should be neutral.

2.26 One member noted that the qualitative characteristic of reliability had been replaced by faithful representation. This member requested clarification as to why the Boards

- made this decision because, in their opinion, faithful representation was no better understood than reliability.
- 2.27 Mr. Hague responded that the comment letter analysis bore out the Boards' belief that reliability was misunderstood. While processing the comment letters it became clear to the staff that there are many varying views on the meaning of reliability. The disparity amongst the comment letters on this topic also suggested that reliability was understood by constituents in a way that was not originally intended.
- 2.28 One member asserted that the qualitative characteristic of understandability should be the focus. The reasoning given for this is that everything becomes more complex if it is not understandable, therefore no test of relevance would be met.
- 2.29 Mary Barth, IASB Board Member, reiterated the Boards' decision to put understandability and relevance in a category of enhancing characteristics specifically so they could affect both of the primary qualitative characteristics. The Boards felt they had strengthened the framework by taking this approach.
- 2.30 Some members questioned whether or not the Boards had really defined the term *users*. These members wondered if users should be considered from the lowest level of expertise or if a specified level of expertise should be required. Mr. Hague indicated that users refers to neither of the two extremes (i.e. those that have no knowledge versus those that are highly educated). Users is intended to refer to an average person having a reasonable knowledge of accounting and finance.
- 2.31 Some members took exception to the inclusion of potential investors and creditors as primary users of financial statements. These members were concerned that a potential investor or creditor would have the right to impose additional costs on existing shareholders due to differing information needs. Some members thought that preparers should accommodate the information requirements of existing shareholders, not future shareholders.
- 2.32 Philippe Danjou, IASB Board Member, indicated that many Board members viewed present and potential investors as having the same information requirements. As a result, the Boards did not see the need to make a distinction based on information needs.
- 2.33 Some members expressed concern that the definition of a primary user group risks excluding other user groups. These members believe that if the primary user group is defined as present and potential investors and creditors, their interests will achieve preference over all others. These members wondered if protections can be enacted to safeguard the interests of those that do not fall into the primary user group.
- 2.34 Mr. McGregor stated that the focus is on for-profit entities. It is in this context that the Boards made the decision to classify investors and creditors as primary users. The pervasive thought is that meeting the needs of the primary user group will meet the needs of the wider user community.
- 2.35 Some members would like the reference to *others* in the definition of users to be removed because they believe its inclusion implies that financial statements should cater to the public and public interest at large. If the Boards decide to retain this term, these members believe that the term others should be defined narrowly, especially in consideration of the cost/benefits of providing information to such an amorphous group.

- 2.36 Other members responded to this by noting that many governments have adopted IFRS. As a result, it may become increasingly important for the IASB Board to consider defining what is meant by the term public.
- 2.37 Patricia O'Malley, IASB Board Member, indicated that the real distinction to be made is whether governments use IFRS or whether governments use the statements prepared by people who use IFRS. She reminded the members that it is not the IASB's mandate to write standards for governments.
- 2.38 Some members wanted to know if the Boards had considered making external financial reporting a subset of internal financial reporting. These members thought it strange that external financial reporting would evolve from anything other than internal financial reporting. Of particular concern was the chance that, if external reporting was not explicitly linked to internal reporting, a situation may arise where two separate reporting models develop.
- 2.39 Mr. McGregor responded that while one would like to believe that there is a continuum between internal financial reporting and external financial reporting, this is not always the case. The information used to prepare external reports may not be used internally, even though it should be.
- 2.40 Mr. Hague offered the idea that external financial reporting focuses on providing what is necessary for external users of the information, regardless of what reporting is being done for internal purposes. There are instances where internal reporting may be insufficient for external users.
- 2.41 One member requested an update on discussions related to the definition of an asset and how it will interact with internally generated intangible assets, specifically internally generated goodwill.
- 2.42 Mr. Hague indicated that internally generated goodwill will be addressed as part of the discussion about the definition of an asset. It will also be addressed again during the recognition phase of the conceptual framework project.
- 2.43 One member requested clarification as to the definition, criteria, and boundaries of the term unit-of-account.
- 2.44 Ms. Barth explained that unit-of-account has to do with how you think about what you are accounting for. One example of the challenge surrounding unit-of-account discussions is whether or not a linked portfolio should be viewed as a single unit-of-account or if each individual item in the portfolio should be viewed as the unit-of-account. Many questions remain regarding what is the appropriate level of aggregation versus disaggregation in terms of measurement.

#### Breakout Session—Stewardship Discussion

- 2.45 Ms. Lian introduced the discussion of stewardship to the SAC members. She explained that many respondents to the discussion paper disagreed with the assertion that the objective of financial reporting should be focused on resource allocation decisions. She went on to explain that the staff plans to use the feedback received from the breakout session in subsequent presentations to the Boards.

#### Breakout Session Summary—Group One

- 2.46 David Lindsell summarised the discussion in his breakout session group. Mr. Lindsell began by expressing the group's concern that the term stewardship may literally not translate well into other languages. He indicated that there had been

- much discussion trying to pinpoint exactly what stewardship meant and that many meanings considered by the group had an aspect of trusteeship to them.
- 2.47 Mr. Lindsell went on to explain that the discussion tended to involve three or four different themes. It was generally thought that stewardship was a more “backward” looking approach and that it connoted accountability for past actions. This was contrasted with the greater emphasis in the draft conceptual framework on the predictability of future cash flows. This was seen as a forward looking approach that has more to do with resource allocation than accountability. Concern was expressed that the emphasis on future cash flows could lead to a reduction in the type of historical information typically used to assess stewardship.
- 2.48 Mr. Lindsell commented that every time the group discussed the sort of information required to assess stewardship, the conversation often veered towards the topics of disclosure and management commentary. Those individuals who expressed scepticism about the need to explicitly articulate stewardship as an objective of financial reporting said the type of information being asked for by proponents of stewardship would be included in financial statements anyway. In the end it was generally accepted to be quite difficult to identify information that would be useful exclusively for assessing stewardship that would not also be of use for making resource allocation decisions.
- 2.49 Mr. Lindsell went on to say that if one accepts the premise that all information can be grouped under the heading of resource allocation then obviously there would be no need to identify stewardship separately as an objective of financial reporting. On the other hand, the number of constituents in opposition to subsuming stewardship within resource allocation cannot be ignored. He went on to share a practical approach for the Boards to consider: acknowledge the views that have been submitted to the Boards in support of stewardship and explain what problems may arise by explicitly delineating stewardship within the framework.

#### Breakout Session Summary—Group Two

- 2.50 Heinz-Joachim Neubürger summarised the discussion in his breakout session group. Mr. Neubürger began by discussing the group’s thoughts on paragraph OB2 as it was presented in the discussion paper. He said that many group members thought the objective of financial reporting required boundaries in respect of cost/benefits and timeliness.
- 2.51 Mr. Neubürger went on to say that members felt the definition of a user required additional boundaries, particularly the “other users” class. Some members felt that government regulators should explicitly be excluded from the category of other users. Many members expressed their reluctance to give carte blanche to anyone that may have information demands.
- 2.52 The group also indicated their desire to see more work done on the term usefulness. Members felt that the manner in which it was defined was too broad, thereby making it weak.
- 2.53 As far as the purpose of financial statements is concerned, members expressed their belief that the focus should remain on cash flow style information.
- 2.54 Mr. Neubürger went on to say that stewardship, depending upon where someone comes from, is something that is highly influenced by language, culture, and legal environment. Stewardship is a concept that people struggle to understand. Because

of its prominence in many societies, stewardship needs to be reflected in the conceptual framework. He cited jurisdictions where dual board structures exist and therefore, by law, the split of stewardship responsibility is very clear.

#### Breakout Session Summary—Group Three

- 2.55 Jochen Pape summarised the discussion in his breakout session group. Mr. Pape began by indicating that the ASB had recently published on its website a paper on stewardship. He thought the IASB should take into account the ideas in this particular paper as the Boards continue their deliberations on stewardship.
- 2.56 Mr. Pape went on to say that stewardship is not just a UK issue; many in the group observed that stewardship typically is a point of departure for American and European Board members. One member indicated that perhaps stewardship really is a regional issue, especially since it is not seen as a significant issue in the US. Others thought that stewardship is used interchangeably with the term accountability which is a concept that is already part of the current objective of financial reporting. Mr. Pape noted that throughout the discussion some members used stewardship and accountability interchangeably while others saw the two terms as related but different. He also indicated that stewardship has an emphasis on current owners that may conflict with the definition of users in the discussion paper that includes both current and future owners.
- 2.57 With regard to the objective of financial reporting as it was outlined in paragraph OB2 of the discussion paper, Mr. Pape indicated that many believe the Boards are opening a sort of Pandora's Box of additional information that must be provided to all manner of users of financial statements.
- 2.58 Mr. Pape indicated that, overall, there was sympathy for the definition of the objective of financial reporting presented in paragraph 7 of agenda paper 1B. Support for this definition was predicated on limiting the amount of new disclosures that may be required.

#### Open Forum

- 2.59 One member spoke about the commonality of each group's experience in being unable to find any aspects of financial reporting that are included in stewardship but do not also fit under the heading of resource allocation decisions. However, with the large number of constituents that are clearly a bit uncomfortable with the way the current discussion paper was written, something must be done to find middle ground. One member suggested moving some of the content of paragraphs OB27 and OB28 up a bit higher in the framework so that they appear immediately following the objective of financial reporting in paragraph OB2. This may provide constituents with the additional emphasis on stewardship that they are requesting. Another member thought that it may also be helpful to shorten some of the paragraphs as they are quite long. The very clear message on discharge of responsibility that stewardship conveys may have been lost in the text.
- 2.60 One member indicated that the definition of stewardship is not a trivial question. This member challenged all those in attendance to imagine the difficulty in translating the word so that a precise meaning is achieved. Without such a result there would be significant difficulty in applying the concept of stewardship consistently in all jurisdictions.

- 2.61 Some members expressed concern that the FASB's recent statement about the conceptual framework debate will start to influence the development of standards at the IASB. Other members wondered if, since the framework will have to be adopted by the EU, it will become part of the branding debate.
- 2.62 Sir David responded that the framework is part of the IASB's standards setting process. If an answer cannot be found in a standard, the conceptual framework is referred to for guidance. The primary thrust of the conceptual framework is on developing a rigorous foundation from which the IASB's standards may be produced. The entire point is to have a consistent theme running through the IASB's accounting standards. He advised members that the conceptual framework is a living entity that will continue to grow and change over time.
- 2.63 Ms. Barth added that FASB's statement was intended to put constituents in the US on notice that accounting is going to be changing in the near term. Everyone will need to consider the conceptual framework when answering accounting questions.
- 2.64 Gilbert Gélard, IASB Board Member, acknowledged that while it is good that the US is endeavouring to upgrade the conceptual framework within the US GAAP hierarchy, preparers and users should be careful about wanting this to become law. Doing so may lead to unintended consequences.
- 2.65 One member responded that this is precisely why his organisation did not advocate passing the conceptual framework into law. His organisation did not want to be backed into the position of supporting an accounting standard simply because it had supported the conceptual framework.
- 2.66 Another member indicated that the point of the conceptual framework is to facilitate the move to principles based accounting standards. In this member's view the conceptual framework must be endorsed by everyone because it drives the direction that the profession is moving in. If the conceptual framework devolves into a tool with no real practical use, then there is a bigger problem. This member thought that perhaps consensus needed to be achieved as to why so much energy and resources are being devoted to developing the conceptual framework.
- 2.67 Tatsumi Yamada, IASB Board Member, reminded members that the conceptual framework is part of convergence. If the IASB were to develop a conceptual framework that differs from FASB, the two Boards would be operating from different foundations. There would then be no guarantee that the Boards would interpret accounting issues in the same manner. The conceptual framework is needed so that consistency between standards setters may be fostered. Additionally, the conceptual framework will provide a common platform for future Board members to work from, thereby fostering consistency between Board members over time. The conceptual framework is a basic, fundamental tool.

Session Summary—Board Member

- 2.68 Mary Barth summarised her understanding of the stewardship discussion. Ms. Barth began by reiterating the idea that stewardship means different things to different people and its understanding depends heavily upon where an individual comes from. Translation issues magnify the need to determine what stewardship is; we need to develop better phrases or words to describe what we mean by stewardship. One challenge is determining how stewardship may be turned into a global concept and then how it may be communicated in the objective of financial reporting.

- 2.69 Ms. Barth shared the Boards' understanding that because of the strength of feeling constituents have on the topic of stewardship, it must be addressed. At this time, it is not clear that different information would be required for assessing stewardship versus making resource allocation decisions. However some thought that management commentary may play more of role in a discussion of stewardship than it might necessarily play for resource allocation decisions. One concern is that, if the Boards set too broad an objective of financial reporting, information explosion in the form of corporate governance and sustainability reporting may be the result.
- 2.70 Ms. Barth shared some of the items that members would like the IASB staff to consider. In the next due process document, many would like the staff to explicitly articulate how cost/benefits fit into the objective of financial reporting. Additionally, many members would like for parameters to be set around who the other users of financial statements might be. Finally, the IASB staff should consider both the ASB paper and the EFRAG paper on stewardship as the project moves forward.

### **3 Discussion of IASB Work Plan and Convergence**

- 3.1 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
- 3.2 Sir David noted that the SME exposure draft was issued in February 2007; to date, it has been translated into three languages. The staff has begun to field test the proposed guidance. Sir David stressed that the SME document is very much a work in progress. The staff and the Board are attempting to make it a self contained document that deals with the kinds of transactions that would be most relevant to small and medium sized entities. He indicated that the Board would like feedback as to whether or not the right options were chosen or if some of the options provided for in the document should be eliminated. Additionally, the Board would like to know if members think certain areas should be simplified and, if so, what the best approach to simplification would be.
- 3.3 Sir David noted that meetings had been held with the new Chair of the Accounting Standards Board of Japan. Sir David invited Eiko Tsujiyama to comment on the ASBJ's convergence programme. Ms. Tsujiyama reiterated the Chair of the ASBJ's commitment to achieving convergence with IFRSs.
- 3.4 Sir David noted that he would be meeting with representatives of the Indian Accounting Standards Board. At present the Indian Board has tentatively set a deadline of 2011 for the adoption of IFRSs. Sir David invited Shailesh Haribhakti to comment on the Indian Accounting Standards Board's convergence programme. Mr. Haribhakti explained that the Indian Board had established a convergence committee. The committee came to the conclusion that convergence is possible within a definite future period and presented its findings to the Indian Accounting Standards Board. Mr. Haribhakti indicated that the business community in India is very supportive of convergence. Both the government and various regulators have been pushing the

- Indian Board to accelerate its adoption of IFRSs. To that end the Indian Accounting Standards Board is developing a detailed work programme to adopt IFRSs.
- 3.5 Sir David went on to explain that the IASB has been conducting regional meetings to liaise with different national standards setters. One of the recent meetings was held in the Philippines, a country that has already fully adopted IFRSs. The meeting was attended by representatives from Malaysia, Taiwan, and Indonesia. The focus of these meetings was on learning the different problems each country is having in making the transition to IFRSs and how the challenges have been overcome.
- 3.6 Sir David asked Julie Erhardt, official observer from the SEC, to comment recent developments with regard to the convergence of IFRS and US GAAP. Ms. Erhardt said that on 20 June 2007, the SEC Commissioners voted to issue a proposal to accept IFRS prepared financial statements from foreign private issuers. The proposal will be available on the SEC's website and in the Federal Register for a seventy-five day comment period.
- 3.7 Ms. Erhardt explained that the proposal is to accept financial statements from foreign private issuers prepared using IFRSs as they are promulgated by the IASB. Additionally, the financial statements must be accompanied by an audit report covering the preparation of the financial statements in accordance with IFRSs as they are promulgated by the IASB. The proposal also discusses how functioning in a "two GAAP market" may be operationalised. The proposal sets the stage for a concept release on the idea of accepting IFRS prepared financial statements from US issuers.
- 3.8 Sir David finished the discussion of the IASB's work programme by talking about several different projects that have the potential for changing accounting. He indicated the Board has divided views on many of the topics up for discussion in the near term therefore respondents' comments will be of genuine value to the Board.

#### Open Forum

- 3.9 One member asked if the IASB intends to produce a document that specifically identifies the differences between the SME standards and full IFRSs. Elizabeth Hickey, IASB Director of Technical Activities, responded that the staff has provided a broad analysis which was posted to the IASB's website. She indicated that, at this time, there are no plans to produce a detailed analysis of the differences between the two sets of standards
- 3.10 Some members indicated general support of the SMEs exposure draft. However, these members would like to see redeliberations focus on field testing.
- 3.11 Sir David indicated that one of the areas of confusion is what type of entity the SME standard should apply to. The Board had sought to make it clear that individual jurisdictions will determine where the line should be drawn. The determination of whether or not an entity is a SME is necessarily a function of the local economy.
- 3.12 Many members acknowledged that while the recent moves made by the SEC towards removing the reconciliation requirement for foreign private issuers are a major step forward for the US and IFRS, it is a small step forward for Europe. Some members believe that the requirement to use full (London) IFRS ignores the legal environment in the EU. Many members would like the SEC to consider accepting financial statements from foreign private issuers that are prepared using IFRS as adopted by the EU.

- 3.13 One member noted that the SEC may be working very hard on achieving something that will not satisfy EU requirements. For example, CESR often refers to “endorsed” IFRS which is not the same type of IFRS that the SEC is considering requiring. This member pointed out that European companies are not operating in a legal vacuum—financial statements must be prepared in accordance with IFRS as adopted by the EU. For these companies, full (London) IFRS is currently not a legal option. This member also expressed the opinion that the IASB and the FASB will never produce identically worded standards, therefore some sort of reconciliation requirement will probably be required for the foreseeable future.
- 3.14 Some members responded with their belief that the EU made a mistake by saying “IFRS as adopted”. These members believe that the first group to lose in this discussion will be the Europeans. Fighting between the EC, European Parliament, and the IASB is not beneficial. If anything, the SEC’s proposal is one more reason for Europe and the IASB to resolve their differences. Additionally, these members believe that all companies should adopt IFRSs as they are promulgated by the IASB.
- 3.15 One member countered that there is a very real risk that some of the next standards issued by the IASB will not be endorsed by the EU. The IASB should see this action as a warning from the EU that, going forward, the EU probably will not endorse the work the IASB is doing. This member believes this is a plea for the IASB to recognise and understand the negative reaction to the work that is being done.
- 3.16 Mr. Jones reminded the SAC members that IFRSs are not solely the providence of Europe. Any country has the right to adopt IFRSs. Unfortunately, the IASB cannot prevent a country from modifying IFRSs. Mr. Jones indicated that the SEC is not going to accept anything other than full IFRS. He believes that it does not make sense for the SEC to support what amounts to adopted regional standards.
- 3.17 Some members indicated their belief that US preparers would require detailed interpretation from the SEC in order to prepare IFRS financial statements. These members wondered if this would make the SEC both the de facto standards setter and interpreter of IFRSs.
- 3.18 Sir David responded that the SEC has held back from interpreting IFRS and has stopped standards setting by speech. He noted that all regulators have to take decisions as enforcers.
- 3.19 One member pointed out that every standards setter has the right to ask the SEC for exemption from the reconciliation requirement. This member indicated his belief that the SEC is being given the ability to pass an opinion on different jurisdictions’ separate financial standards. For Europe to maintain its franchise, Europe must maintain the ability to determine what IFRS is and what it is not.
- 3.20 Sir David responded that the objective of International Financial Reporting Standards is to develop one single set of accounting standards, not twenty-seven. The entire point of the convergence work programme is to eliminate the reconciliation requirement. Currently there is significant confusion as to whether or not a company is actually following IFRSs. If national interests keep carving out different aspects of IFRSs, global standards will never be achieved.
- 3.21 One member indicated that the debate has less to do with standards setting and more to do with access to capital markets. This member indicated that the EC should require US issuers accessing European capital markets to reconcile their financial statements to IFRS as it is adopted by the EU.

- 3.22 Several members questioned what the removal of the reconciliation requirement means for the MoU in general and the convergence programme specifically. Some wondered if the effort to converge US GAAP and IFRSs will slow down once the requirement is removed. Others indicated that the process is speeding up on the US side not because of the quality of IFRSs but because so many companies are fleeing the US's capital markets—in essence, the SEC's hand has been forced. These members pointed out that the MoU was signed two years ago under a very different economic environment. Now that the context has changed, perhaps the MoU should be revisited.
- 3.23 Sir David responded that the MoU was carefully crafted to require a continuing commitment to convergence. He also indicated that the accounting landscape has changed because of the MoU. At first, the IASB Board focused on fixing the standards that it had inherited from its predecessor body; next, short term convergence became a priority. Now the Board has moved on to addressing fundamental accounting questions in conjunction with the FASB. To that end, the next four or five years will result in the culmination of several significant joint projects. Sir David said that it would be a great mistake if the MoU was questioned now.
- 3.24 Ms. Erhardt indicated that the SEC welcomes comments on the overarching question of dropping the reconciliation requirement based on a single set of global standards. She encouraged individuals that believe this approach to be a bad idea to write a comment letter.
- 3.25 Ms. Erhardt said that a concept release relating to US issuers using IFRS will be published by the end of summer. She also indicated that they did not know how long it would take to go through all of the comment letters in relationship to the proposal. Redeliberations will help the SEC Commissioners decide both how and if to go forward with the proposal. As a result, there is no firm date as to when a final release on the topic will be issued.
- 3.26 Ms. Erhardt continued by saying that the working assumption is that convergence will continue on. She acknowledged that standard setting takes time and that forward progress needs to continue. She also indicated that the SEC views the proposal to eliminate the reconciliation requirement for foreign private issuers as a logical step given the text of the MoU.
- 3.27 Ms. Erhardt reminded the SAC members that the SEC had never previously asked for broad input on eliminating the reconciliation requirement for foreign private issuers. Additionally, the SEC has never spoken publicly about operationalising the existence of two GAAPs [US GAAP and IFRS] in US capital markets. Ms. Erhardt indicated that the SEC has become emboldened by feedback received on these issues at a recent round table meeting. Presently, the SEC does not see any changes in its approach to enforcement, especially since the regulation of domestic and foreign issuers have always been approached differently by the SEC. Ms. Erhardt reiterated that any regulator has to enforce the rules of their capital markets.
- 3.28 Some members wanted to know whether or not the removal of the reconciliation requirement will apply for year-ended 2008 financial statements. Ms. Erhardt responded that the SEC Commissioners are specifically looking for feedback on what the appropriate timing and transition should be. A definitive answer can only be given once all respondents' comments have been received and considered.

- 3.29 With regard to specific projects that are part of the work programme, one member asked for a status update on the impairment project. This member indicated that it is difficult to achieve convergence without commonality in this area.
- 3.30 Wayne Upton, IASB Director of Research, indicated that the staff is addressing impairment on two fronts. He reminded the SAC members that the impairment project is one that the FASB had promised to lead on. Additionally, the IASB has a seconded staff member whose focus has been researching the topic of impairment. Mr. Upton indicated that the IASB has devoted the time to conducting the research and it is now up to the FASB to determine the approach for moving forward on this project.
- 3.31 One member indicated his support for the government grant and emissions trading project. Ms. Hickey indicated that this particular project had been deferred at the IASB. She acknowledged that FASB had just added a similar project to its technical agenda. Ms. Hickey explained that the relative priority of the government grants and emissions trading project was being assessed in comparison to other projects.
- 3.32 One member questioned the requirement in the financial statement presentation project to split the balance sheet into categories that individuals are not currently accustomed to using. From a cost/benefit perspective, this member envisaged tremendous cost but no benefit to users of financial statements. He asked for an update of the IASB's intent.
- 3.33 Ms. Hickey indicated that the output of phase B of the financial statement presentation project will be a discussion paper later this year. She said that many issues are being dealt with in the discussion paper. The objective is to promote cohesiveness across the different types of financial statements as well as make it easier to explain changes from period to period. Currently there are three proposals for this; all three proposals will be presented in the discussion paper for comment.
- 3.34 One member requested information on the status of the draft principles based standard. Sir David indicated that the IASB staff prepared a draft standard and sent it to the major accounting firms for review. The firms were asked whether or not the draft standard was auditable. Once feedback has been received from the accounting firms, the document will be sent to various regulators. Regulators will be asked whether or not the proposed principles based standard can be regulated. Sir David indicated that some of the early feedback had been very encouraging.

#### **4 Financial Instruments**

- 4.1 Gavin Francis, IASB Senior Project Manager, presented the background to and the intended approach of the financial instruments due process document scheduled to be issued in the beginning of 2008. He went on to explain that the forthcoming document was envisaged as part of the MoU between the IASB and the FASB.
- 4.2 Mr. Francis explained that the paper sets out the long term objectives of the IASB and FASB in relation to the accounting for financial instruments. There are a number of issues that need to be resolved before the Boards can achieve their long term objectives. He indicated that one of the key objectives of the due process document is to seek the view of respondents as to how the Boards might achieve their long term objectives. The paper discusses the approach and possible content of the due process document.

- 4.3 Mr. Francis indicated that a fair value measurement model is one way to improve and simplify accounting and financial reporting for financial instruments. It is intended that the due process document will discuss how and why such a model would improve financial reporting and reduce complexity associated with understanding, interpreting, and applying the current accounting guidance for financial instruments.
- 4.4 Mr. Francis said that an alternate way forward might be to change existing requirements in some way without going so far as to require fair value measurement of every financial instrument. Such changes may reduce the complexity associated with understanding, interpreting, and applying current accounting guidance for financial instruments. Additionally, this approach may be seen as an interim step towards achieving the Boards' long term objective.
- 4.5 Mr. Francis cautioned that when the Boards have discussed a path forward for the financial instruments project, the Boards have stressed: 1) any changes should be significant in nature—they are not interested in doing a sequence of small changes; and 2) that any change must constitute a move forward from current guidance. For example, derivatives will continue to be measured at fair value and this decision will not be reconsidered.

#### Open Forum

- 4.6 Some members express concern that the needs of users of financial statements are not being adequately considered. The agenda paper discusses a fair value model for financial instruments, however indications exist that users are not in favour of such a change to accounting. These members believe that fair value is supported only for highly liquid instruments and that debt should be carried at par value. These members also wondered whether or not the two Boards have sufficient support from users of financial statements to move to a fair value model.
- 4.7 Some members asked if, in the due process document, the staff will make the choice between the fair value model and proceeding with interim steps to change existing guidance. Many members indicated their preference for presenting the two options without offering a staff recommendation.
- 4.8 Mr. Francis responded that the intention is for the due process document to explain ways the current standards may be simplified. He indicated that the due process document will not contain any preliminary views.
- 4.9 Some members felt that users generally do not have a problem with fair value. From these members' perspective, the issue is in extending the application of fair value further in accounting. This is linked to financial statement presentation of fair value changes—preparers are not willing to accept more volatility for the sake of fair value. These members indicated that many fear they are going to be pushed to a full fair value model when they are not ready for it.
- 4.10 One member asked if the staff would be willing to incorporate a survey of how different companies account for an array of financial instruments as part of the research for the project. This member shared his belief that variability in accounting for financial instruments happens because of the nature of each financial instrument. One concern raised by this member was the challenge of verifiability and consistency in determining fair values.
- 4.11 One member responded that the CFA asked users of financial statements what they want in terms of valuation and, for financial instruments, users have asked for fair

value. This member acknowledged that legitimate concerns exist as to how fair value may be applied in certain circumstances. Of particular importance is whether or not debt should be carried at fair value. For debt, both the par value and fair value numbers have significance. This member indicated that the volatility inherent to financial instruments is real, however the manner in which it is communicated in the financial statements is another issue.

- 4.12 One member expressed his belief that IAS 39 cannot be consistently applied. He also indicated that regulators are able to adjust any of the numbers in the financial statements. If adjustments are consistently required, a problem more than likely exists with the accounting. Many companies are showing asset values in their balance sheets that are not capable of absorbing losses. Additionally, valuation models being used in practice are not sophisticated enough. This member said that all stakeholders will ultimately gain from accounting's move towards fair value.
- 4.13 One member indicated that the long timeline of the project gives participants the opportunity to anticipate both the complexity of the issues and the push back from constituents that may be received. He went on to say that the complexity of IAS 39 is due largely to the transitional guidance contained in the standard.
- 4.14 Another member indicated that the "fair value option" has already provided an interim step to reduce complexity in accounting for financial instruments. He advocated gaining experience from those who are implementing the fair value option in their accounts. This member does not believe that fair value will need to be required—finance people already view the fair value option as a life line for understanding their business. He also indicated his belief that research will show the absolute relationship between risks in their portfolios is not clear to banks. For example, valuing credit spread is extremely difficult to do; knowing at what point to stop refining a model can also prove tricky. This member also wondered what type of valuation guidance will be supplied to auditors.
- 4.15 Some members questioned how to go about reconciling the SAC members' conflicting assertions about what users want. One member indicated that the varied opinions about users' needs are likely the result of a difference in opinion between US and European analysts. Another member responded that the IASB should not be listening to what users say; the IASB should be considering what they actually do. To this member, it is absolutely clear that capital markets respond to changes in fair value.
- 4.16 One member indicated that significant problems exist with implementation of IAS 39. He pointed out that the number of people who understand IAS 39 is minimal. He observed that even though people do not like change, they also do not like IAS 39. This member recommended laying out the implications of following each path in the discussion paper.
- 4.17 Some members indicated that even though they support the expanded use of fair value in accounting, many questions remain as to what sort of valuation guidance should be issued by the IASB. These members specifically wondered how the modelling of fair value may be expanded.
- 4.18 Mr. Upton responded that the IASB is in a difficult spot determining how best to respond to requests for the issuance of more guidance regarding modelling. He referenced SFAS 157, asking whether the valuation guidance it contains is useful outside of developed markets. Mr. Upton encouraged the SAC members to consider

whether the valuation guidance in SFAS 157 is at a level that answers many of the concerns presented earlier in the discussion. He indicated that if it is not, the IASB will necessarily go beyond what the FASB provided in SFAS 157. Even though the comment period is over, Mr. Upton advised the members to review the IASB's fair value discussion paper.

- 4.19 Sir David added that IAS 39 has been interpreted by experts within their own expert groups and they still have not reached consensus as to what the accounting standard conveys. Another problem is that IAS 39 was developed as an offshoot of SFAS 133. Sir David emphasised that all aspects of IAS 39 are up for review. For example, the staff will be asking questions like whether effectiveness testing is necessary and if hedging of portions is still a viable option. He commented that the discussion paper should be viewed as a directional paper—these are the problems and these are the possible ways that we may proceed to resolve them.
- 4.20 One member presented an approach for the IASB to consider. First, the IASB should commit to conducting a significant amount of field work on this issue. The impact of any change to existing practice should be assessed with banks of all sizes. The staff should take care to understand how much time it will take to develop new valuation models and/or modify existing models. Second, the staff should invite regulators to participate in this process, so that they are on board with what the IASB is proposing.
- 4.21 Some members expressed concern that the discussion paper will attract negative comments from preparers in European companies because of their recent switch from national GAAP to IFRS. European companies are still trying to master a very steep learning curve therefore a grace period is needed before anything new is broached.
- 4.22 One member expressed his consternation with spending endless hours carving up financial instruments for embedded derivatives. This member indicated his belief that hedge accounting is no longer a viable option and that there must be a better way to absorb model changes than what is currently in place. Put another way, changes in a financial model should not add volatility to the financial statements.

#### Session Summary—Board Member

- 4.23 Patricia O'Malley summarised her understanding of the financial instruments discussion. Ms. O'Malley began by noting the fair degree of consensus among the SAC members in terms of their feedback for the Board and the staff on this project. She acknowledged many members' willingness to proceed with a due process document, especially since so many feel that IAS 39 is unsustainable in its current form. She also said that members seem to consider the approach outlined in the agenda paper to be reasonable for advancing the discussion on developing a replacement for IAS 39.
- 4.24 Ms. O'Malley briefly recapped the additional comments made by the SAC members. The staff and the Board need to refocus some of the decisions and reasons for why the IASB and FASB have reached the views that they have regarding their long term vision for accounting for financial instruments. Time should be spent validating the extent to which the long term goal really meets the needs of financial statement users. As part of the document's due process, constituents should be surveyed as to how financial instruments are being accounted for in practice. Additionally, constituents should be asked how useful (or not) the fair value option in IAS 39 is.
- 4.25 With regard to taking interim steps towards the Boards' long term vision, Ms. O'Malley acknowledged the SAC members' request that the Boards be precise in

describing exactly what it is that they are suggesting. She reiterated that the implications of each possibility should also be clearly articulated. Ms. O'Malley emphasised that the Boards are as unattracted as the SAC members to embarking on a project comprised of a series of small interim steps. She clarified that the discussion is really about whether an interim step will be undertaken versus moving immediately to the long term objective. Whatever the interim step may become, it must be capable of satisfying potentially inconsistent criteria—for example, moving forward and reducing complexity.

- 4.26 Ms. O'Malley noted that the next steps in the process should be clearly identified. The type and extent of field work to be done by the staff should also be decided upon sooner rather than later. Additionally, resolving financial statement presentation issues will be fundamental to making any progress in the area of accounting for financial statements. Ms. O'Malley observed that some of the presentation and communication issues may be more critical than some of the recognition and measurement questions.

## **5 Agenda Proposals**

- 5.1 Ms. Hickey began the agenda proposals discussion by indicating that the staff is seeking preliminary input regarding agenda decisions to be taken by the Board later in the year. She reminded the SAC that agenda decisions are normally taken in July; this year, the Board will be taking them in December. Formal agenda proposals will be presented to the SAC members at the November meeting. The Board is also seeking input for possible agenda items that have not yet come to the Board's attention. Ms. Hickey commented that feedback from the SAC members on both the agenda proposals and the existing technical agenda helps both the staff and the Board with prioritisation.
- 5.2 Ms. Hickey reminded the members that the IASB is subject to resource constraints. She indicated that current staff is effectively allocated to existing projects—therefore resources may be available only to take on a very limited number of new agenda items. Three potential agenda items form the basis for the discussion: intangible assets, management commentary, and common control transactions.
- 5.3 Mr. Upton presented the preliminary agenda proposal for the intangible assets project. He began by indicating that the intangible assets project has been part of the Board's research agenda for some time. The staff of the Australian Accounting Standards Board has been working with the IASB to develop an agenda proposal for the project. The agenda proposal will be presented to both the IASB and FASB Boards; if the proposal is accepted, the project will be added to both Boards' technical agendas as a joint project.
- 5.4 Mr. Upton explained that the agenda paper contained an extract from the draft agenda proposal describing what an intangible asset project might entail. The staff is proposing to explore requiring companies to measure and recognise intangible assets that are currently not captured in their respective balance sheets. He clarified that only those intangible assets that unquestionably meet the definition of an asset are within the proposed scope of the project. Examples include copyrights, trademarks, patents, and trade secrets. He indicated that these intangible assets are essentially from the same family of intangible assets required to be measured and recognised as part of a business combination.

- 5.5 Mr. Upton went on to say that feedback from companies that have attempted to find and catalogue intangible assets indicates that the task can be difficult. This would be one of the challenges for operationalising an intangible asset standard. He went on to say that an intangible asset project would require a discussion paper, a working group, and would be long term in nature.
- 5.6 David Loweth, acting Technical Director of the UK ASB, presented the preliminary agenda proposal for the management commentary project. Mr. Loweth presented the staff's analysis of the comment letters received in response to the October 2005 discussion paper on this topic.
- 5.7 The main question asked in the discussion paper was whether respondents considered management commentary to be an integral part of financial reporting: 92% of those who responded said "yes". Mr. Loweth indicated that respondents were mixed as to whether the requirements should be issued as a standard or as guidance. A majority of respondents thought management commentary should be a priority for the Board; the minority pointed to the IASB's already lengthy technical agenda as the reason for not making it a priority.
- 5.8 Mr. Loweth indicated that the objective of management commentary is to put the financial statements in the context of the environment in which the entity operates; set out what management sees as the most important issues facing the entity; and assess management's strategy in terms of its chances for success. Most respondents agreed with this objective.
- 5.9 Mr. Loweth indicated that the staff found no discrepancy between responses received to the management commentary's discussion paper and the conceptual framework's discussion paper as to whether management commentary should be part of financial reporting.
- 5.10 Michael Stewart, IASB Project manager, presented the preliminary agenda proposal for the common control transactions project. Mr. Stewart indicated that a number of organisations have requested guidance on accounting for common control transactions, specifically common control business combinations. Common control business combinations are those business combinations where the controlling party both before and after the transaction is the same entity.
- 5.11 Mr. Stewart noted that these types of transactions are specifically excluded from the scope of IFRS 3. This leaves preparers with a choice for determining what the most appropriate accounting policy should be for these types of transactions. He explained that there are three principal methods that are being used in practice: 1) acquisition accounting (i.e., apply the requirements of IFRS 3); 2) fresh start accounting; and 3) retain the existing book values.
- 5.12 Ms. Hickey indicated that the Board members regularly receive feedback from constituents about projects they would like the IASB to address. Sir David indicated that constituents have expressed interest in the IASB developing an accounting standard for the extractive industries (oil, gas, mining, etc.) and that an international working group is studying the issues and working on developing a proposal.
- 5.13 Sir David indicated that accounting for agriculture has been raised as an issue in both the Philippines and Malaysia. Mr. McGregor continued that a number of jurisdictions have concerns about the application of IAS 41. These jurisdictions do not believe that the existing standard is appropriate for valuing bearer biological assets; for example, assets like orchards, palm oil plantations, coffee plantations, and

grape vines. IAS 41 would require the bearer biological asset to be valued at fair value each reporting period and the produce from the bearer asset would also be accounted for at its fair value when it is harvested. The concern is that the use of fair value in these instances causes volatility in financial statements. Additionally, the standard focuses exclusively on the biological asset and does not include other assets that are a part of the production process. Put another way, only one asset in the production process is subject to fair value while everything else is carried at historical cost.

- 5.14 Mr. Upton reminded the SAC members that both the staff and the Board would like advice on priorities. He acknowledged that while all of the projects are worth doing, some may view certain projects as being more important than others. He reminded the members that staff would be refocused in the coming months on the government grants and emission rights project.

#### Open Forum

- 5.15 One member shared his support for turning the output of the management commentary project into a set of guidelines—or best practices—for developing countries. He indicated that this may help accountants in developing countries determine what information should be in the notes and disclosures of the financial statements and what information should be outside of it.
- 5.16 Many members indicated their desire to see the IASB focus on projects like the conceptual framework instead of broadening the current work programme. Some of these members feel that the completion of the conceptual framework project may resolve the need to add new projects to the technical agenda.
- 5.17 Several members expressed interest in adding the management commentary project to the agenda because they believe it will have the best return on the staff's effort. Additionally, work on the project may help the conceptual framework staff to answer questions regarding the scope of financial reporting. These members acknowledged users' requests for narrative reporting and supported the claim that it would add value to a company's financial reporting in total. Questions about auditability were raised as well as concerns about infringing upon the work already done by domestic regulators.
- 5.18 Some of the members who were against adding the management commentary project to the technical agenda indicated a desire to see the IASB develop more implementation guidance for preparers. These members felt that getting the numbers "right" was the most important goal. If the numbers are incorrect, there is little need to comment on them.
- 5.19 One member took the position that the government grants and emission rights project is the only one that should be acted upon at present. This member did not view intangible assets to be a significant current issue. He also questioned whether or not management commentary should be seen as a priority for the Board. He emphasised his belief that the needs of users should be clarified and recommended setting up a special session for users.
- 5.20 Some members agreed that the project on common control transactions should be brought onto the technical agenda with the caveat that the scope must include transactions with the controlling party itself. These members indicated that minority shareholders would find common control transaction information important due in part to stewardship concerns.

- 5.21 Some members supported bringing the intangible assets project onto the technical agenda. Of particular importance to these members were issues surrounding internally generated intangible assets. Other members countered that the intangible assets project would be far too large for the staff and Board to tackle at this point, given the extensive list of large projects that are already on the technical agenda.
- 5.22 Some members indicated their desire to give priority to filling obvious gaps in IFRS. These members placed as their highest priority a project on developing accounting standards for extractive activities. Other members cautioned that the extractive industries were not ready for the response they may receive from the IASB in this area.
- 5.23 Mr. Carvalho summarised the discussion by noting the existence of many conflicting views. A show of hand by the SAC members indicated that those members advocating a suspension of all additions to the technical agenda until current items are completed were in the minority.

## **6 Post-employment Benefits**

- 6.1 Andrea Pryde, IASB Project Manager, described phase 1 of the post-employment benefits project. Ms. Pryde explained that the project has two main sections. The first section deals with deferred recognition and presentation while the second section addresses problems experienced in accounting for cash balance plans.
- 6.2 The Board has tentatively determined that all changes in the value of both the plan assets and the post-employment benefit obligation should be recognised in comprehensive income in the period in which they occur. Ms. Pryde indicated that the Board has not yet reached a decision on where in comprehensive income these changes should be recognised. She explained that the main reason for this decision was to enhance transparency. In the past, the deferred recognition model has been criticised for not recognising value changes in the period in which they occur. Many believe the existing model adds a layer of complexity that makes it difficult for users to understand what has happened.
- 6.3 Ms. Pryde went on to discuss the requirement in IAS 19 to recognise an expected return on plan assets in profit or loss. She explained that this requirement is criticised for providing entities with the means to manipulate profit or loss by choosing the expected return. The staff has been informed that there may be large differences between the expected and actual return on plan assets. Ms. Pryde said that the Board tentatively decided not to require the return on plan assets to be divided into an expected return and an actuarial gain or loss.
- 6.4 Ms. Pryde then described how changes in plan amendments are recognised. The Board's tentative decision that all pension obligation changes are recognised in comprehensive income in the period in which they occur also applies to situations where an entity either amends an existing plan or introduces a new plan which attributes benefits to past service. Ms. Pryde indicated that concerns have been expressed with this decision and the staff will be readdressing the issue with the Board at the July 2007 meeting.
- 6.5 Ms. Pryde indicated that the Board has not yet come to a preliminary conclusion as to how the components of pension costs should be presented. The Board believes that it may be premature to do so in light of progress made on other projects, particularly

the financial statement presentation project. She also noted that there has been no discussion on the presentation and display of components of pension cost. The staff has chosen to use the discussion paper as one avenue to seek constituents' views on how components of pension cost may be presented and displayed so that their information usefulness is enhanced.

- 6.6 Ms. Pryde indicated that three approaches to the presentation of components of pension cost will be included in the discussion paper. The approaches are intended to illustrate different ways of providing information on the components of pension cost as well. They are also meant to consider some of the commonly expressed views on presentation. The first approach is to recognise all changes in profit or loss in the period incurred. The second approach is to recognise only service costs and their associated gains and losses in profit or loss. Approach three is a remeasurement approach that presents changes arising from shifts in financial assumptions as price-type changes that will be presented outside profit or loss.
- 6.7 Jenny Lee, IASB Project Manager, continued the discussion by presenting the section on cash balance plans. Ms. Lee indicated that the Board wished to consider a wider range of plans than those that were specifically examined when IAS 19 was written. She noted that defined return plans are currently classified in IAS 19 as defined benefit plans and it is difficult to account for them as such. The Board assessed the key characteristics of cash balance plans and tentatively decided to carve out those plans where the entity has an obligation in respect of the promised return on actual contributions. All other types of benefit promises will continue to be treated in accordance with IAS 19 (i.e., they will be regarded as either defined contribution or defined benefit plans). Ms. Lee indicated that the staff is in the process of clarifying both the definitions and the measurement approaches.
- 6.8 Ms. Lee went on to explain that the Board tentatively concluded that defined return promises have two components: the actual contributions payable and the promised return. The Board has tentatively concluded that the liability in respect of the promised return should be measured at fair value while the liability associated with the unpaid contributions should take into account the time value of money.
- 6.9 Ms. Pryde completed the presentation by sharing how the staff plans to proceed. She indicated that the staff is being assisted by an employee benefits working group that met for the first time on 5 June 2007. The group considered expanded versions of the papers given to the SAC members and were broadly supportive of the proposals they contained. The working group raised a number of concerns which will be addressed with the Board at the July meeting. The discussion paper is expected to be published in the fourth quarter 2007.

#### Open Forum

- 6.10 Many members supported the Board's decision to require the recognition of changes in the value of both the plan assets and the post-employment benefit obligation in comprehensive income in the period in which they occur. Additionally, most members supported the Board's decision not to require the division of return on plan assets into an expected (or estimated) component and an actuarial gain or loss component. One member indicated his preference for at least disclosing the expected return in the notes to the financial statements if it was not going to be separately presented in the balance sheet.

- 6.11 One member indicated that it may be appropriate to subject the recognition of the liability associated with past service costs to a materiality test. This member indicated that there may be instances where a plan change results in such a significant liability that it would be more appropriate to spread the recognition of that liability over the life of the plan.
- 6.12 Other members supported the Board's decision to require the immediate recognition of a liability when plan amendments or the introduction of new plans generate past service costs. These members cited stewardship as the basis for their position. One member explained that, if management introduces something that either creates or increases a liability, one way to hold them accountable for their decision is to require the immediate recognition of the liability.
- 6.13 Ms. O'Malley offered clarification on the topic. She explained that if the amended plan had actually been in place from inception, the company would have already recognised the entire amount because IAS 19 already treats unvested benefits as part of the accounting for the liability. She reminded the members that the vesting issue is not what creates the liability, it is the attribution of the service and, in this case, all of the service has already taken place and should therefore be recognised.
- 6.14 Ms. O'Malley pointed out that very often in negotiations with organised employee groups, management trades off current versus deferred compensation. She went on to explain that the one major difference between private sector and public sector accounting for post-employment benefits in Canada is that the public sector requires the immediate expensing of costs associated with prior service. This is done on the basis that governments have an even greater tendency than managements to try and leave problems for the next administration. When current increases are traded off for improvements in pension benefits, it is important to get an accurate accounting for the liability that the government has just entered into. Ms. O'Malley indicated that this is an opportunity for the private sector to catch up with the public sector on this particular issue.
- 6.15 Mr. Upton indicated that most of the discussions about actuarial gains and losses have been in the context of either changes in plan assets or plan amendments. The actuarial profession has begun to indicate that the latent problem is life expectancy.
- 6.16 Several members asked for clarification of approach three (remeasurement) for presenting the components of pension costs. Mr. Upton explained that the approach is modelled on the idea of cost accounting variance and the desire to isolate different reasons why a particular number may change. This approach is also consistent with what seems to be the reason for entries being made in other comprehensive income—that is, price changes. He went on to indicate that the two price change elements of a pension obligation are the discount rate and the fair value of the plan assets. He also said that breaking up amounts in this way injects an element of arbitrariness. Ultimately the goal was to use elements of cost accounting to isolate price differences from volume differences.
- 6.17 Some members indicated that they favoured approach one but only because the other two approaches were so obviously unsatisfactory. For example, approach two provides for no distinction in profit or loss between funded and unfunded schemes. Members indicated that this approach simply will not work because it is inconsistent with other accounting, specifically accounting for provisions. Approach three goes back to some sort of realised basis which many considered to be a retrograde step.

- 6.18 Other members indicated that it is very difficult to find a principle in this area. The difficulty stems from the volatility of what is a very long term obligation. Even though some members saw approaches two and three as being unworkable, they were not convinced that the IASB would have success with approach one either. One member indicated his belief that preparers would revolt if they were required to reflect the entire pension cost in profit or loss.
- 6.19 One member wondered if it was really necessary to introduce cash balance plans as a third category of pension plans along with defined benefit and defined contribution plans. This member indicated that many different types of new, innovative plans are surfacing in response to companies' attempts to find workable solutions for providing post-employment benefits to their employees. Many of these new plans cannot be defined as either defined benefit or defined contribution plans; the cash balance plan definition will not help either.
- 6.20 Another member offered an alternate way to categorise post-employment benefit plans. One category of plans may be those where the company has either written a cheque for a specific amount or made a promise for a defined quantity of benefit; another category may be those where the company has written a cheque, however it is a blank cheque—the company does not really know the amount it is ultimately liable for. What companies have really done (from an accounting perspective) is committed themselves to a blank cheque promise, even though the nature of the promise does not line up with traditional defined benefit plans. He also shared his concern that companies will game the system if a third type of plan is defined.
- 6.21 One member pointed out that if the answer to this problem had been easy, the IFRIC exposure draft would have gone through. He acknowledged that many plans around the world do not fit comfortably within the traditional notions of defined contribution or defined benefit plans. He also indicated that while every type of plan may not be addressed, the staff's proposal sorts out quite a few of the problematic ones and is a practical approach.

#### Session Summary—Board Member

- 6.22 Jan Engström summarised his understanding of the post-employment benefits discussion. Mr. Engström acknowledged the strong level of support shown by the SAC members for the current direction of the project. He reiterated the support given for recognising changes in plan assets in profit or loss when they occur as well as the desire to eliminate smoothing activities. There was also strong support for not requiring the division of the expected return from the actual return. Cautious comments were received regarding the decision to require the immediate recognition of prior service costs associated with plan amendments. He pointed out the confusion that accompanied the discussion of presentation, and noted that most members supported approach one although the Board was encouraged to seek out different options. Mr. Engström also noted members' question as to whether or not a third type of plan is really needed.

## **7 Business Combinations**

- 7.1 Alan Teixeira, IASB Senior Project Manager, briefly updated members on the business combinations project. He noted that the Board planned to complete balloting on a revised IFRS 3 *Business Combinations* and amendments to IAS 27 *Consolidated and Separate Financial Statements* by 30 June. He summarised the

significant changes made by the FASB to converge with IFRS 3, the one change made by the IASB to converge with FASB Statement No. 141, *Business Combinations* (the elimination of the reliable measurement criterion for the recognition of intangible assets) and the improvements to existing standards made by both Boards.

- 7.2 The focus of the discussion on the business combinations project was on an early draft of part of a feedback statement for the amendments to IAS 27. In April 2007, the IASB announced that it will publish a new, stand-alone feedback statement when issuing major standards to explain its approach to addressing the main themes raised through the comment letter process. The staff asked members for input on the tone, depth of analysis and content that feedback statements should contain.

#### Open Forum

- 7.3 Members generally supported the Board's efforts to develop feedback statements. Members observed that feedback statements will be useful in filling a gap between the standard and the basis for conclusions and in demonstrating the Board's accountability and transparency.
- 7.4 Several members noted the importance of carefully considering the intended audience of feedback statements and then drafting the statements accordingly.
- 7.5 Most members suggested that the length of feedback statements should be limited in order to make the statements accessible to readers. Members suggested that the statements focus on the key issues raised in comment letters and include cross-references to relevant paragraphs in bases for conclusions, where appropriate, to avoid repetition.

#### Board Member Summary

- 7.6 Warren McGregor summarised his understanding of the business combinations discussion. Mr. McGregor indicated that the Board heard fairly general support for the development of feedback statements although some members expressed concerns about the resources that may be devoted to the task and perhaps questioned whether the resources would be better applied to working on more standards. Overall, members indicated that feedback statements will play a very important role in filling a gap between information in the basis for conclusions and the exposure draft. Constituents may see the document as an important part of the overall due process of the IASB; it also may be viewed as an attempt by the Board to demonstrate its accountability to its constituents and add to the transparency of its processes.
- 7.7 Mr. McGregor noted that the intended audience for the feedback statements needed to be considered when drafting the statement. Many members expressed concern over the depth of analysis to be contained in the document. These members indicated a danger in making the document too long with the concern being that it may become impenetrable. Suggestions included not covering all of the questions or issues, focusing on only the controversial issues, and considering the intended audience for this document. Additionally, the staff may want to consider linking the document back into the basis for conclusions to limit repeated information.
- 7.8 Contrary views were also articulated. Some members expressed their belief that the document should be as long as it needs to be and that the staff should not feel compelled to cut corners. The importance of the document was emphasised, particularly in the context of dealing with controversial issues.

- 7.9 Mr. McGregor went on to say that members generally supported the content of the document as it was articulated in the agenda paper. One recommendation was that the staff may wish to highlight any industry or geographical biases in the comments that were received during due process. Another idea was to include an explanation of how roundtable participants and working group members are selected.
- 7.10 Mr. McGregor observed that not a lot of feedback was provided by the members as to how the document would be best communicated to constituents. Some members felt that including the document on the IASB's website was enough.

**END**