

**Minutes of the Meeting of the
Standards Advisory Council
held in London on 8 and 9 November 2007**

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SAC Members:

Attending:

Adir Inbar
Alberto Giussani
Benoît Atangana Onana
Charles McDonough (World Bank)
Christine Ramon
David Lindsell
Eiko Tsujiyama
Hector Vela
Henning Göbel (IAIS)
Ian Ball (IFAC)
Ingebret Hisdal
Jochen Pape
Judith Downes
Kenneth Sullivan (IMF)
Michael Cangemi
Nelson Carvalho, *Chairman*
Patrice Marteau
PM Kam
Richard Thorpe (CESR)
Rifaat Karim
Robert Morgan
Sylvie Matherat (Basel Committee)
Shailesh Haribhakti
Toshihiro Horitomo (Asst. to Mr. Yagi)

Trevor Harris
Yoseph Asmelash (UNCTAD)
Yoshiki Yagi
Will Widdowson

Apologies:

Anna di Michele
Christoph Ernst (IOSCO)
Danny Teoh
Frank Brod
Hector Estruga
Heinz-Joachim Neubürger
Jose Antonio Alvarez
Mauro Grande
Wang Jun
Sarah Deans
Suk-Jun Lee
Vladimir Preobrazhenskiy

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IASCF Trustees:

Alicja Kornasiewicz
Phil Laskawy

Sir Bryan Nicholson

* * *

IASB Members:

Gilbert Gélard
Jan Engström
John Smith
Mary Barth
Robert Garnett

Stephen Cooper
Tatsumi Yamada [9 November only]
Tom Jones
Warren McGregor
Wei-Guo Zhang

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IASB and IASC Foundation Staff:

Amanda Quiring, Project Manager
Amy Schmidt, Project Manager
April Pitman, Project Manager
Denise Gomez-Soto, Project Manager
Henry Rees, Senior Project Manager
Kathryn McArdle, Executive Assistant
Liz Hickey, Director of Technical Activities
Michael Buschhüter, Project Manager
Peter Clark, Senior Project Manager
Sandra Hack, Technical Associate
Tom Seidenstein, Director of Operations IASCF
Wayne Upton, Director of Research

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Other Guests:

Alicia Posta (FASAC Director)
Dennis Chookaszian (FASAC Chairman)
Ulf Linder (European Commission)

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Observers:

Jenifer Minke-Girard (SEC)
Johannes Jeroen Hooijer (European Commission) [8 November only]
Kyoko Imanishi (FSA)

1 Opening Remarks

Welcome

- 1.1 The SAC Chairman, Nelson Carvalho, welcomed participants to the meeting. He reminded the attendants that the Remembrance Day for those who died in war is in a few days and handed over to David Lindsell. David Lindsell gave a short explanation of the commemorations initially held for the end of the First World War on the 11th day of the 11th month. He asked for a minute of silence for all the veterans.
- 1.2 Mr Carvalho then introduced Will Widdowson and Christine Ramon, new members to the SAC. Mr. Carvalho also welcomed Alicia Posta and Dennis Chookaszian from the US FASAC. Then he introduced Jeroen Hooijer as an official observer from the European Union Commission, Jenifer Minke-Girard, representing Julie Erhardt from the US SEC and Kyoko Imanishi, replacing Junichi Maruyama from the FSA, Japan, as an observer. Mr Carvalho announced that Sir David Tweedie apologised for this meeting and Sir Bryan Nicholson for lateness.

Update

- 1.3 Mr Carvalho, SAC Chairman, updated on his activities since the June 2007 SAC meeting. He noted that a subgroup of SAC had provided input to the Trustees on strategic matters and priorities. Mr Carvalho mentioned the promotion of IFRS, the assessment of SAC effectiveness and the challenge of communication as constant issues.

2 Session with Trustees

- 2.1 The discussion with the Trustees was divided into three parts: general update, strategy review and a session about the role of SAC members.

General Update

- 2.2 Phil Laskawy, Chairman of the IASCF, spoke to the members of SAC in his general update about the rapid pace of politics in international accounting, which seems to be moving even faster.

Strategy Review

- 2.3 Mr Laskawy pointed out that the goal of the Trustees is to have the most effective organisation, to ensure that the Board has the best circumstances to get standards promulgated and to have the FASB as a partner in doing so.
- 2.4 Mr Laskawy explained that as the IFRS have actually entered the world stage, the processes in this institution are to be reviewed. The IASCF's Trustees have committed themselves to the objective of one set of international accounting standards for all parts of the world, for use in the world capital markets. Although the

IASCF's Trustees are representing several regions and countries; they all try to do the right thing in respect of their common vision – despite different cultural backgrounds and different business environments.

- 2.5 Mr Laskawy thanked again Tommaso Padoa-Schioppa for his excellent work, even though it only lasted for a few months. Mr Laskawy reminded that he accepted the interim chair to have the time for finding the best replacement for Tommaso Padoa-Schioppa. The Trustees found Gerrit Zalm a very fortunate choice as being thoughtful, focussed and willing to enter into the same commitment. Mr Laskawy expressed his view that Gerrit Zalm is the right person as a chairman in times like these as the IASCF will go through some changes and to have a European chairman at this moment makes sense. But still the IASCF has to focus on the whole world, embracing Europe and the USA, and must devote time to other countries.
- 2.6 Mr Laskawy emphasised that the IASCF is at a point where consideration is needed of the governance of the foundation. He referred to the work on the constitutional review and the development of a strategy. He asked for feedback, views on each point and critics from the SAC.
- 2.7 Then Mr Laskawy referred to the press release which covers most of the strategic issues. In general, the aim should be to establish a formal reporting link to official organisations. He welcomed the idea of some organisations monitoring the IASCF, but was also concerned about the effectiveness of this monitoring. He had the idea of a small group of 6 to 8 persons who would focus on Trustee appointments, to have a final say on the appointments and on the chair of the Trustees. He stressed that he does not want the Trustees becoming a political institution or a politically driven organisation, in order to ensure the current independence.
- 2.8 Mr Laskawy handed over to Tom Seidenstein, IASCF Director of Operations who raised some issues regarding the public accountability and emphasized the regulatory perspective.
- 2.9 Several SAC members stressed the importance of the Board's independence and recognised as the most controversial point the Trustees appointing themselves. They also expressed their concerns that a monitoring organisation should perform a certain kind of oversight, mainly the selection of the Trustees, but nothing more. And underlined that the practical impact has to be assessed beforehand. They were worried that this body could get too much power and felt a need to ensure that the Board stays independent. Several SAC members agreed that the IASCF should not become a political institution, and predicted that if so, there would be struggles about the composition of this body.
- 2.10 One SAC member noted that if the Trustees are monitored and the Trustees monitor the IASB, the Trustee's monitoring group will monitor the IASB either way.
- 2.11 Mr Laskawy answered that oversight is required. But the oversight of the Board will still be with the Trustees. Fundraising and appointing Trustees will be the issues of the monitoring group. There is no reason for concerns that the monitoring group will affect the independence of the Board.
- 2.12 One SAC member explained two different concepts to deal with the current public accountability issues. The first was to crucially defend the independence, the second to find methodologies e.g. for the nomination of the Trustees, being just a nominating committee, not monitoring. When choosing the second concept he reminded that - by definition - one would need to have representatives from all the stakeholders.

- 2.13 Mr Laskawy gave his opinion that the Trustee Appointments Advisory Group comprises really wise people and they are a great help for the nominating process. But this has nothing to do with the regulatory concerns or the perceived lack of accountability.
- 2.14 One SAC member requested that acceptable standards should be the goal. Not only understandable, but acceptable, which means whilst staying independent to take into account political views and consider them.
- 2.15 Another SAC member underlined the growing enthusiasm in the United States about convergence. The preparers in particular expressed that it is beneficial to go to the IFRS, partially because they have been using it for several years.
- 2.16 This SAC member stressed that the adoption of IFRS is a surrender of sovereignty. On the demand for an institution of international standard setting, it is a matter of fact that the countries of the world are about to give up a part of their sovereignty. And it has to be considered that this is new ground for the countries of the world to delegate the making of binding law to a non-governmental institution. He expressed his opinion that the Trustees should stay self-appointing, but having an oversight on this.
- 2.17 Another SAC member said she supported a monitoring group as long it is to prove the function of the Trustees to appoint and the importance of independence is remembered. The monitoring group should just approve the appointment of Trustees not propose on its own. She recommended a greater involvement to the Trustees by interested parties, but not within technical debates. She was concerned with combining the funding with the monitoring and suggested a separate group who has credibility to the funding.
- 2.18 Mr Laskawy mentioned that they are working on independent funding and that the SAC could help to get there.
- 2.19 Another SAC member mentioned how crucial the nomination of the first Trustees was and it is essential to replicate these skills and background for the forthcoming Trustees. And that it is worth pursuing to have supervision on the accountability of the Trustees.
- 2.20 One SAC member underlined his support for the Board's independence and of a panel as described. The goal of the panel has to be crisp and clear and confined to the selection of the Trustees, the nomination and a veto. The funding should be elevated under consideration.
- 2.21 Jeroen Hooijer, official EC observer, mentioned that the European Union commission together with the United States, Japan and IOSCO have the general idea and an agreement among these countries for the Board's independence. The Board's independence is not at stake and it is not being for or against independence. The European Union is a big customer of the IFRS and expressed a certain degree of criticism, but this time it is not about the standards, but about the agenda and the nomination of the Trustees. Due to the endorsement process, the European countries gave up a part of their sovereignty. He reminded that there is no other private institution, which makes binding rules and does not have any point of public oversight. The European Union does not want to be engaged in the detailed standards, but wants to see public oversight. Furthermore he requested that new standards need to undergo an impact assessment to assure the consistency with the framework and the acceptability of the standards. The European Union commission

- recognised the efforts of the due process, but it is to be regarded as an ongoing process and the European Union commission wants to work closely with the IASB.
- 2.22 Mr Chookaszian mentioned his experience regarding the funding of his institution. At first the funding of the FASB was provided by corporations voluntarily, but now it is funded by the SEC and the SEC taxes corporations to generate the funds needed to support the standard setting process. While the SEC provides funding, it does not interfere in the standard setting process. He noted that the IASCF faces the same issue of credibility, and independence as experienced in the US, and this will not be solved by creating an oversight organisation. The only way to establish credibility is to have a strong independent process for Trustee nominations.
- 2.23 One SAC member expressed her view that the amendments to eliminate net income are not reasonable and asked the IASCF's Trustees on their opinion. Mr Laskawy answered that with due respect to the independence of the IASB he will not comment on a technical issue, such as this.
- 2.24 Bryan Nicholson, IASCF Trustee, said that he had a discussion with Dennis Chookaszian and Ian Ball in New York at the time of the Trustee's last meeting. They collectively accepted that a relationship among each other is a must. The monitoring group should reflect that. Also, the IASCF is already in talks with all the regulators.
- 2.25 Another SAC member asked why the IASCF is creating something new instead of improving the existing institution and mentioned that this is opposing the notion of independence of the Board and the IASCF.
- 2.26 Ms Minke-Girard clarified that the FASB (and PCAOB) is funded by an accounting support fee that is collected from public companies, and the billing is done by the PCAOB. The funds for the FASB do not come out of the SEC's budget or from the US Treasury.

The role of SAC members – ambassadors for IFRS

- 2.27 Mr Laskawy stated that the IASCF has the intention to strengthen the role of the SAC, in order to improve the value of SAC for the Board members and as spokesmen in their countries.
- 2.28 One SAC member replied that first of all the SAC has to be convinced that the standards are just like they should be. And he asked if he should be an ambassador of the IFRS already in existence or the standards that are about to come or for the IASB.
- 2.29 Mr Laskawy noted that the IASB seeks SAC's input but it is the IASB's job to elaborate the standards. The IASCF does not see the SAC as ambassadors of certain standards. But even if some members disagree with specific standards, they should be ambassadors of the idea of the institution and the IASCF.

3 Discussion of IASB work programme and convergence

- 3.1 Mr Carvalho opened the session by introducing new Board members, Stephen Cooper and Wei-Guo Zhang.
- 3.2 Tom Jones, IASB Vice Chairman, outlined the three main strategic objectives of the IASB at the present time:
 - (a) encouraging more countries to switch to IFRS rather than use national standards;
 - (b) convergence of IFRS and US GAAP; and
 - (c) development of a standard for SMEs,and gave an overview of recent events.
- 3.3 He noted that new countries were adopting IFRS e.g. China and Brazil and that the IFRS are moving towards being applied in the most nations all over the world.
- 3.4 He expressed his view that in the last 12 months the mood in the United States has changed and that now there is an audience for IFRS. This is mostly due to the subsidiaries of the big American companies.
- 3.5 Mr Jones explained that the mortgage problems in the United States have given the IFRS a challenge, because it was a test for the fair value concept, but it really worked out. There was great support even from those who suffered from the write-offs.
- 3.6 He reported that most of the respondents are very positive about the SME standard project. Basically, the standard was written for the emerging markets, but the SME standards get positive respondents from all over the world.
- 3.7 Mr Jones gave details about the branding project and gave some background information about the impact of carve-outs.
- 3.8 At this point Mr Jones recognised the probable elimination of the reconciliation requirement for IFRS in the United States. If the SEC actually accepts IFRS, it will not accept IFRS as adopted by any country using carved-out IFRS.

The IASB Work Plan – convergence with US GAAP

- 3.9 Wayne Upton, IASB Director of Research, highlighted some issues on behalf of David Tweedie regarding the IASB's work plan. He mentioned that at the moment, liabilities and revenue recognition are prominent issues. A further issue is short-term convergence regarding income taxes by eliminating exceptions. He reminded that the SAC will have the opportunity to express their opinion about the priority of new agenda proposals on the next day.
- 3.10 Liz Hickey, IASB Director of Technical Activities, mentioned the current developments of the business combinations project. The standard is finished, but before publishing the standard there will be a feedback statement to point out how carefully the standard was prepared.

- 3.11 She then addressed major items which are on the current agenda. The consolidation project is making progress. The project is aiming to replace IAS 27 and SIC-12 where the major question is 'when do you have a subsidiary' and therefore the definition of control. The aim is to produce a discussion paper. In the conceptual framework project there are two main issues: the objective and qualitative characteristics will hopefully be finished at the end of the year. Recently discussed were the notions of stewardship or accountability.
- 3.12 Mr Upton referred to the financial instruments project. There will be a new joint project with the FASB determining liabilities and equity. He also referred to the work on puttables. At the moment the project is aiming for a limited, precise fix. An early draft of changes will be discussed at roundtables next week.
- 3.13 Mr Upton pointed out that the heavy lifting regarding equity liability distinction was with the FASB this time. The FASB devoted their time to two models – the ownership/ settlement-model and the direct ownership model. The FASB currently prefers the direct ownership model. Another topic in the financial instruments project is derecognition in the context of financial instruments. Next year the IASB and the FASB will consider moving financial instruments projects from the research phase to the active agenda of the Boards. In the long run there will be a document replacing IAS 39, incorporating derecognition and hedge accounting, aiming to simplify IAS 39. A simplification generally leads to a single measurement and that will be fair value.

IFRIC activities

- 3.14 Ms Hickey reminded of the implementation work, the efforts of IFRIC and the annual improvements project. IFRIC elaborated two new interpretations and two drafts. The annual improvements project was an outcome of the IFRIC's work. Sometimes it is easier to make an amendment to a standard and so there is the need for an effective way of dealing with these minor amendments. The Board debates the issue, then publishes the intended change which is incorporated in an annual exposure draft. So minor amendments can be handled on a reasonable timely basis. Although the comment period for the exposure draft is just 60 days, the intended changes are published on the website for many months before.

SAC discussion

- 3.15 Some SAC members expressed their concern that the annual improvements should be restricted to minor changes like clarifications and rewording. One SAC member explained that these improvements could be summarised as non urgent minor inconsistencies or unclear wording.
- 3.16 Ms Hickey answered that she is well aware that some of these 'minor' changes will have an impact on people, but the definition of minor does not relate to impact.
- 3.17 One SAC member referred to paragraph 13 of the Chairman's Report to SAC and asked if the objective is to avoid any objection in the United States. He carried on asking if the discussion with the PAAinE was taken into account of the performance reporting project.

- 3.18 Mr Upton related to the PAAinE which was working on pensions, liabilities and equity and revenue recognition and added that their work was exposed to the Board. As well as other experts, PAAinE was invited to explain their work to the Board. The IASB's staff links into their research.
- 3.19 One SAC member asked how government grants should be accounted since there are two possible ways. He highlighted that the amendments to IAS 37 generally got negative comments. So he recommended creating a new standard, or trying to incorporate these comments.
- 3.20 Warren McGregor, IASB Board Member, answered that the exposure draft is under review, some paragraphs were essential, according to a number of constituents.
- 3.21 Some SAC members emphasized that two exposure drafts and seven discussion papers with very important issues to be published in 2008 will set the respondents under pressure, that it is important to have enough time to respond and requested longer exposure periods and more education on the topics. One SAC member asked for more investing in the comment period timing and to avoid permanent differences in the financial statements by getting the countries on board. Some companies have in their segmental reporting duplicate sets of disclosures because of timing differences between issuance of the standard and endorsement. The IASB should pay more attention to the accountability regarding the process. Dates of papers should not be just deferred.
- 3.22 Ms Hickey responded that there are many discussion papers; but that the general comment period is six months.
- 3.23 One SAC member confirmed that the SME standard was very well received, but the support of XBRL is still on development.
- 3.24 Mr Hooijer asked if the IASB is doing an impact assessment for every standard issued. He reminded that the time needed for endorsement in Europe is 12 months.
- 3.25 One SAC member was in favour for an impact assessment on the IT systems of companies and added that in general early adoption is desired, but one year is not enough for the implementation.
- 3.26 Another SAC member mentioned that the accounting reporting change of the 2003 improvements was just the first round and that lots of challenging standards came to implementation in the meantime. He also asked for thinking of its impacts especially on emerging countries.

4 Financial statement presentation

- 4.1 Denise Gomez-Soto, IASB Project Manager, gave an overview of the financial statement presentation project including some preliminary views on the presentation of the statement of comprehensive income and the project's communication strategy.
- 4.2 Ms Gomez-Soto mentioned that this is a joint project with the FASB which began in 2006. The project has been divided in phases A, B and C. Phase A has been completed. For Phase B, a discussion paper will be released in the first half of 2008.

The Working Format and Cohesiveness of the Financial Statements

- 4.3 Ms Gomez-Soto gave further explanations about the cohesiveness principle which means that items (revenues, expenses, assets and liabilities) would be classified consistently in the financial statements at a line item level, according to predefined sections, categories and subcategories, so that entities can understand the relationships between items on the different financial statements. She explained that management would determine the boundaries of the business/ financing sections and of the categories included therein. The entity would be able to explain how and why it chose the items in each category. The basic sections/categories will be the same for financial and non-financial institutions. Illustrations of the proposed working format in the financial statements were included as part of the material distributed to SAC members.

Discussion Questions

- 4.4 Ms Gomez-Soto asked the SAC members if the working principles outlined were complete and if they supported the management approach to financial statement presentation.
- 4.5 Some SAC members expressed their concerns regarding the exact allocation of some line items to the predefined categories. To illustrate this difficulty one SAC member addressed the classification of pension related items and stressed how complex it is to determine if they are operating or financing items. One could find different ways for classifying these items. So the application of the cohesiveness principle would be really difficult in practice. One SAC member needed further explanation of the 'cohesiveness' notion. The main concern of SAC members when using the management approach is the lack of comparability between companies and the lack of consistency that it could cause.. Another SAC member gave the example of assets sold in different currencies and mentioned that while the currency translation adjustment would be displayed in the operating segment, the sale would be displayed in the investing segment; he then wondered how this model could be put together. He supported the management approach but would be also interested in why it is applied in this way.
- 4.6 Other SAC members supported the cohesiveness principle in general, but suggested that another way of segregating items could be based on the level of risk associated to the items in the financial statements.
- 4.7 Most of the SAC members strongly supported the management approach as seeing the business through the eyes of the management, getting a 'functional' balance sheet showing how the company is allocating its assets and liabilities.
- 4.8 Mary Barth, IASB Board member, replied that the Board did not make any decision regarding the allocation to business or financing categories/sections. Once management decides, the same classification has to be applied throughout the financial statements, and this is what is called cohesiveness. This would be an accounting policy with all its consequences.
- 4.9 A SAC member expressed her concern against the use of the management approach as it distorts the comparability between companies. She mentioned that this approach

would depict how a company is doing its business or how a company sees its business

- 4.10 One SAC member asked how that approach could possibly improve the users' understanding of the uncertainty in measurements of individual assets and liabilities.
- 4.11 Another SAC member asked what would be the starting point of the cohesiveness decision: the balance sheet or the income statement.

Statement of Comprehensive Income – Presentation of Other Comprehensive Income

- 4.12 Ms Gomez-Soto gave an overview of the proposals for the presentation of other comprehensive income (OCI).

Discussion Questions

- 4.13 One SAC member opposed a change in the presentation of OCI, especially when this fundamental change is just an interim step. Major changes on the presentation of financial statements (which involve data collection, training and other changes in the IT environment) should be made definitive, not just as an interim step. Generally he preferred to show items in the financial statements by their nature, rather than by their function.
- 4.14 Another SAC member questioned the purpose of an interim step without knowing the final outcome. OCI items have different characteristics. Cash flows derived from OCI items should not be a part of the operating category. Further he explained that fair value measurement changes also have characteristics different from operating items and that tax should be allocated.
- 4.15 Another SAC member recommended allocating tax according to the transaction that gives rise to income taxes, to show which tax items are related to the operations, nonrecurring items, financing and interest expenses. He stressed that he understood the complexity involved in the allocation of taxes, but it is important information particularly with regard to tax efficiency. He recommended that at least an entity should be required to show taxes associated with OCI as he understands that the tax allocation to the financing section and the investing category could be complex. Another SAC member noted that taxes should be allocated to obtain a net income subtotal. Mr Upton remarked that tax allocation could become a really complex issue.
- 4.16 One SAC member added that it is not a question of how complex the issue is. Bearing in mind that tax rates are relevant (usually ranging between 30 to 40 percent) tax allocation is an important disclosure. Additional disclosures in the financial statements should show the actual amount that an entity is paying for taxes. .
- 4.17 One SAC member agreed with the separate presentation of OCI and in particular alternative 2. She highlighted that as long as a multiattribute measurement model exists in IFRSs there will be a need for OCI.
- 4.18 One SAC member requested a performance report to show the various elements of income. He noted that the quality of the information would not be improved by presenting items on a pre-tax basis.
- 4.19 Three SAC members preferred alternative 1, four were in favour for alternative 2 and one was for alternative 3.

Recasting Exercise

- 4.20 Ms Gomez-Soto pointed out that some companies recasted their financial statements using the proposed working format and their results were presented to the Boards at the October joint meeting.

Discussion Questions

- 4.21 Some SAC members asked when the results will be published. Ms Hickey answered that this is a sensitive issue which has to be carefully handled, as participating companies have raised concerns about making results available to the public.
- 4.22 One SAC member requested that the SAC be approached to provide further assistance. One SAC member added that the SAC members could give some assistance for another recasting exercise in the future.
- 4.23 One SAC member expressed his concerns regarding the very burdensome and detailed disclosure requirements of this project. He also stressed the importance of net income. He requested that a field test analysis should be presented to the SAC and the number of participating companies should be increased. Another SAC member stressed that actually the SAC members are not convinced. He requested guidance on how to describe and divide the items.

Summary

- 4.24 Jan Engström, IASB Board member, summarised the session by pointing out the general support for the management approach and for the cohesiveness principle that achieves a better association of items in the financial statements. The model proposed should be further assessed to test if it is helpful to users.
- 4.25 He highlighted that stability is another crucial issue. Taxes are a big topic and in particular their allocation. Further, net income and OCI have different characteristics. The long-term view had its supporters. He stressed that the communication of proposed changes to the presentation of financial statements is important and challenging, to win the heart and minds.
- 4.26 Adir Inbar, SAC member assigned by the SAC chairman to comment on the summary presented by the Board, supplemented and underlined the general support for the management approach and for the cohesiveness principles. Mr Inbar added that more guidance was requested on how to allocate items to the different categories and sections to better predict cash flows and help understanding the uncertainty in measurements of individual assets and liabilities. Regarding the interim versus the long-term view, he remarked on the SAC members' concerns about the project's credibility and the need to clarify what is understood by long-term view. Mr Inbar also mentioned that taxes should be allocated and that the communication strategy should be reinforced.

5 Agenda Proposals

There were presentations on each of the proposals, as follows:

Intangible Assets (excluding Goodwill)

- 5.1 Mr Upton opened the agenda proposals discussion by introducing the issue of internally generated intangibles. He pointed out that several approaches are possible. Each of these approaches had a technical feasible solution but they needed accounting guidance.

Accounting for Emission Trading Schemes

- 5.2 Amanda Quiring, IASB Project Manager, noted that work on the Board's project on the accounting for emission trading schemes has been deferred for nearly two years. Consequently, the Board will be asked to consider whether to reactivate the project or whether to apply its resources elsewhere. She explained that the use of, and interest in, emission trading schemes is growing worldwide. However, it appears that considerable diversity in practice has arisen in the absence of related accounting requirements. She stated that the staff's proposed project plan is to focus first on the accounting for emission trading schemes without broadly considering the accounting for all government grants..

Common control transactions

- 5.3 Michael Buschhüter, IASB Project Manager, presented a proposal to add a project on common control transactions to the Board's technical agenda. The proposal responds to an agenda request by the European Commission who observed that, due to the lack of guidance on the accounting for common control transactions, divergence in practice has evolved on this issue. However, the staff is concerned that a project on common control transactions in general might be very time consuming and delay the issuance of guidance in those areas where it is most urgently needed. Therefore, the staff recommends limiting the project scope to combinations between entities and businesses under common control. Combinations between entities or businesses under common control are business combinations in which all of the combining entities are ultimately controlled by the same party, both before and after the business combination. Those transactions occur often in the context of a group restructuring, such as the legal merger between two or more subsidiaries or the acquisition of one subsidiary by another subsidiary. A project on combinations between entities or businesses under common control would analyse the accounting methods that are advocated in practice for the acquirer's consolidated and separate financial statements and identify those methods according to which those transactions should be accounted for.

Management Commentary

- 5.4 Amy Schmidt, IASB Project Manager, presented the management commentary agenda proposal. Ms. Schmidt indicated that a project on management commentary has been developed based on the premise that narrative reporting is both

complementary and supplementary to the financial statements as well as a necessary component of a decision useful financial reporting package. Issuing guidance on management commentary provides the Board with a number of opportunities:

- it fills a gap for those jurisdictions currently lacking in management commentary requirements;
- it establishes a global base line for narrative reporting;
- it would provide another tool for the Board to use in encouraging the disclosure of information that may not be conducive for inclusion in the notes to the financial statements; and
- it gives the Board the chance to capitalise on the considerable positive sentiment that has been expressed on this project in response to the *Management Commentary* discussion paper.

- 5.5 Ms. Schmidt went on to explain that the agenda proposal proposes to use the conclusions reached in the *Management Commentary* discussion paper as the basis for moving the project from the research agenda to the technical agenda. Ms. Schmidt reminded the SAC members that the discussion paper was prepared and issued on behalf of the IASB by a working group of partner standards-setters.

The process of adding an item to the IASB's agenda

- 5.6 Ms Hickey spoke about the due process to establish a useful, single set of international standards that covers the demands and needs of the stakeholders. She outlined the process of adding a new item on the agenda, and discussed the agenda criteria.

Discussions by the SAC

- 5.7 The SAC expressed a variety of views. Most voted to add common control transactions to the agenda, followed closely by emission rights and management commentary. But a number would not add any project at this time. There was little support for a project on intangibles.
- 5.8 Many SAC members underlined the worldwide need for guidance on how to account for combinations between entities or businesses under common control in the acquirer's consolidated and separate financial statements. SAC members generally agreed with the project scope outlined by the staff. Some SAC members noted that the scope of combinations between entities or businesses under common control is wider than corporate restructurings and also includes transactions with individuals that have common control. However, all SAC members agreed that the project scope should not be extended beyond combinations between entities or businesses under common control. SAC members emphasised the need for international convergence on this issue and recommended that the project be conducted jointly with the FASB and other national standard-setters.
- 5.9 Several SAC members supported reactivating work on the emission trading schemes project because of the international growth of the schemes and the diversity in practice. However, some SAC members noted that the development of emission

schemes is ongoing and questioned the appropriate timing for the Board to consider the topic. That is to say, should the Board fill the void in accounting guidance now, before more schemes are developed and implemented, to stop the diversity in practice from spreading? Or would it be better for the Board to allow a period of time for the schemes and markets to develop before beginning work on the topic to ensure that all relevant issues have been identified?.

- 5.10 SAC members expressed varied views with regard to the IASB undertaking a project on management commentary. Some SAC members expressed their view that the IASB should be looking towards the future of financial reporting and that management commentary is central to the discussion. In support of this point, one SAC member indicated that users are beginning to invest beyond their national boundaries. These users do not have access to important information that would normally be found in management commentary because all jurisdictions either do not require nor do they encourage companies to prepare one.
- 5.11 Several of the SAC members spoke about the need to clarify the link between a project on management commentary and the Conceptual Framework project. These SAC members expressed their concern that work on management commentary may pre-empt work on the conceptual framework. Other SAC members pointed out that there is plenty of management commentary guidance in existence and that it is up to individual jurisdictions, not the IASB, to synthesise it into a more digestible format. Some SAC members pointed to the IASB's Constitution, indicating that the IASB's mandate is to develop accounting standards—not financial reporting standards. The subtext for this argument is that management commentary is not an accounting issue and therefore should not be addressed by the Board at this time.
- 5.12 Some SAC members also expressed their preference that, if a project on management commentary is added to the technical agenda, the IASB work closely with the securities regulators on this topic. These SAC members articulated their concern that the IASB may develop a product that ultimately has little value added when compared to the robust MD&A requirements already in place in the largest capital markets.
- 5.13 Intangible assets were mostly seen as complex due to valuation issues. To solve that problem properly one has to go to the fair value model, which will take another several years. Other SAC members mentioned that IAS 38 is currently working and it does not create many problems, so it would be too early to start with intangibles. Inconsistencies in the accounting models for intangibles were recognised. One SAC member noted that the recognition of internally generated intangible assets without any consideration paid would mean a great shift in the accounting policies. The measurement of intangibles at full fair value is practically really hard to implement.
- 5.14 Some SAC members questioned whether there should be any new agenda items, and it would be more efficient to deal with the things currently on the agenda. Otherwise it would be too burdensome for the respondents. One SAC member stressed that the current projects are important and she would like to see progress in them.

6 Fair value measurement

- 6.1 Peter Clark, IASB Senior Project Manager, introduced the fair value measurement project. He explained that different IFRSs give different guidance on what fair value means. This project aims to eliminate these inconsistencies. He emphasised that the project is not intended to extend the use of fair value beyond cases where IFRSs already permit or require fair value.

Breakout session: Myths about fair value

Myth 1

- 6.2 The first breakout group discussed the myth that the fair value measurement project prejudices the outcome of the measurement phase of the conceptual framework project and is just the next step in a move to full fair value accounting.
- 6.3 A SAC member summarised the discussions of the first breakout group. The group concluded that myth 1 really is a myth. Fair value has different definitions in different standards. The project is researching these inconsistencies. The results could be used in the framework project and could also require the term “fair value” to be replaced with more precise wording. The group suggested the following reasons for the existence of the myth:
- (a) FAS 157 was written mainly with financial instruments in mind, but was then applied more widely.
 - (b) Fair value is the only measurement attribute that solves some issues (eg barter, government grants, customer loyalty programmes), so fair value is being used more than in the past.
- 6.4 The SAC member noted that the first breakout group turned to myth 2 after finishing with myth 1. The group had discussed how to deal with large blocks of shares. A large holding might lead to a higher or lower fair value, and these adjustments might be difficult to quantify.

Myth 2

- 6.5 The second breakout group was engaged with the myth that a ‘fair value’ is a hypothetical value that only works when there is an active, liquid market for the asset or liability.
- 6.6 A SAC member summarised the discussions of the second breakout group.
- (a) The second group wished to rephrase the ‘myth’ so that it states that a fair value is not meaningful unless there is an active and liquid market.
 - (b) A liquid market doubtless makes the measurement of fair value easier, although the group had some concerns about day one gains. But fair value can exist even if there is not such a market. If there are no observable prices, nevertheless fair value exists. Fair value should be used when it is useful for decision making and reliable and when there is enough data that different

people would arrive at broadly the same answer to develop a best estimate. There were different views in the group about where the cut-off lay.

- (c) Fair value provides better information than historical or replacement cost even if there are no liquid and deep markets. Fair value may be applicable in a range of cases for assets and liabilities for which no active market exists, even if an entity has no intention of selling the asset or liability. The first sentence of paragraph 5 of the paper states: "Fair value reflects the current market situation whether or not there is a 'formal' market with quoted prices." This paragraph should be deleted. Transparency about valuation methods is important. This argument will come back when the credit crunch settles down. Paragraph 5 should be expanded to give a more subtle expression of when fair value should be used. It is important to use professional judgement, based on quality data. The second group concluded that the myth, as rewritten by the group, was wrong.

Myth 3

- 6.7 The third breakout group discussed the third myth, namely: if there is no market and the entity has no intention of selling the asset or transferring the liability, a 'fair value' is irrelevant.
- 6.8 A SAC member reported on the discussion in the third breakout group. They viewed this myth as referring to cases where value in use might be preferred. Whenever there is no market the fair value nevertheless exists. Even if an entity has no intention of selling or transferring, they would still call this value fair value. The group rejected the myth. To avoid an overly theoretical approach, the definition of a fair value has to be clear. If one buys an asset at a low price and defines that as a fair value, this will distort the future returns from the asset. Obviously, without a certain degree of information, fair value is difficult to measure as long as the notion of fair value is not clearly defined. Using fair value could mislead the market in some cases. Disclosure is needed to correct the market's perception.

Summary

- 6.9 Mary Barth, IASB Board member, summarised the session.
 - (a) Group 1 clearly understood that myth 1 is a myth and that the project is on 'how' and not 'when' to use fair value. Maybe this outcome will help in the conceptual framework project, but it will not prejudge the outcome of the framework project. The Board will carry out a standard by standard review of when fair value is currently used, and this review may help to dispel this myth. FAS 157 talks about non-financial items on the back of a discussion about financial items.
 - (b) Group 2 understood that that myth 2, as rewritten, is also a myth. Admittedly, if a market exists, the measurement is easier. But even without a market, fair value has great information value. The group highlighted the importance of professional judgement and of having adequate data available. Disclosure is very important.
 - (c) Group 3 recognised that myth 3 is also a myth: fair value exists even if there is no market and for some assets and liabilities fair value can be useful

information. The discussion should include examples of particular cases (such as assets held for defensive value, or bargain purchases), so that the discussion is not just at a conceptual level. Disclosures about fair value are important. In addition, fair value reflects what market participants would expect and not the strategy of the company, so disclosure is important.

- 6.10 One SAC member requested the IASB to take into consideration a basic example: if an item was not cheap one would not buy it. That is a strategy. But the balance sheet needs 'normal' prices. What could be done with these assets if no market exists and there is no intention to sell? It is just a concept that the market can judge how effectively the entity uses these assets. Paragraph 8 of the paper implies a premature conclusion that fair value is more meaningful than value in use. The staff agreed that the wording of the paper did not reflect the staff's intention, which was to reflect a more neutral position at this stage of the debate.
- 6.11 Judith Downes, SAC member assigned by the SAC chairman to comment on the summary presented by the Board, commented on the need to test any wording on fair value very carefully before publishing it, to avoid misunderstanding.
- 6.12 Ms Downes underlined the need for more discussion on when fair value is useful and when it is not and on the obstacles to using fair value in certain circumstances, such as for intangible assets.
- 6.13 Mary Barth responded that the Board would look at these issues in the measurement phase of the project on the conceptual framework.

7 Revenue Recognition: Project Update

- 7.1 Ms Hickey gave a short introduction to the project before handing over to the project managers to introduce the agenda paper.
- 7.2 April Pitman, IASB Project Manager, outlined the history and the background of the joint project with the FASB to develop a single comprehensive revenue recognition standard. In particular, she explained that the staff and a group of board members (drawn from both the IASB and FASB) had developed two revenue recognition models over the past year. The objective is to explain both of these models in an initial due process document to be published in 2008.
- 7.3 She then presented a high-level overview of both these models, using the simple example in paragraph 24 of agenda paper 6 to illustrate how the accounting differs under the two approaches.
- 7.4 Some SAC members expressed their concerns about how revenue in the so-called measurement model could be more or less than the amount of consideration specified in the contract. The staff noted that the illustrative example showed just one way of disaggregating the changes in the exit price of a performance obligation and that there are other presentation options that would result in a more familiar revenue line.
- 7.5 Several SAC members underlined the risk of recognising revenue in advance of that revenue being realised, and therefore the need to explore more fully the issue of when obligations in a contract are satisfied. They were also concerned about the

estimations that might be necessary to determine the measurement of the performance obligations, especially the effect that errors in these estimations would have on any 'day one' revenue recognised under the measurement model. They mentioned their doubts about reliable outcomes in practice.

- 7.6 Another SAC member added that the accounting should be determined by the progress of the contract, eg by determining what percentage of the goods and services have been delivered. That was usually the point when the margin was recognised—in proportion to what the customer got and according to the transfer of risk.
- 7.7 One SAC member noted that the Boards will need to demonstrate why the models provide better information to users, in particular how they would improve users' ability to predict future cash flows.
- 7.8 Another SAC member questioned whether both models would come to the same results in a simple cash transaction. It was noted that in the measurement model, revenue was based on the price a market participant would charge for providing the good or service. Therefore, even in a simple cash transaction, revenue would not necessarily correspond with the cash (ie there might be revenue and a contract gain or loss).
- 7.9 Mr McGregor mentioned that day one revenue may create a discomfort for some, but it can be an appropriate reflection of the underlying economics. Revenue recognition at inception is just one side of the issue. It was important to note that there are also day one expenses, ie expenses involved in obtaining a contract.
- 7.10 Gilbert Gelard, IASB Board member, summarised this session. He explained that although two models had been presented and the agenda paper focussed on the differences between those models, SAC members should note the similarities between the two models. In that regard, he noted that the Board needed to consider further the question about when an obligation is satisfied to ensure consistency in both models. He reminded SAC members that day one revenue does not typically result in a corresponding amount of day one profit. Nonetheless he acknowledged that revenue recognised at contract inception is perceived to be risky, especially on long-term contracts. He also noted that under the measurement model revenue would not necessarily be the same as the amount of the consideration received, however he observed that this is primarily a display issue.
- 7.11 Alberto Giussani, SAC member assigned by the SAC chairman to comment on the summary presented by the Board, emphasised that a SAC member had raised the question of whether the models would improve cash flow prediction.

8 Insurance Contracts

- 8.1 Peter Clark, IASB Senior Project Manager, summarised agenda paper 7 and invited responses to the questions posed in the paper.
- 8.2 SAC members made the following comments:
 - (a) Several SAC members emphasised that the discussion paper is exceptionally well written and well structured.

- (b) Should insurance contracts be viewed as financial instruments or as service contracts? The definition of insurance contracts in IFRS 4 is good. Insurance contracts should not be squeezed into accounting that is more suitable for financial instruments. If insurance contracts are viewed as service contracts, it may be appropriate to use IAS 18. The staff commented that insurance contracts seemed to combine both service and financial instrument elements but separating these elements could probably be difficult and perhaps arbitrary.
- (c) The three building blocks described in the discussion paper are appropriate, although some aspects of the building blocks require further discussion.
- (d) Margins in practice are an implicit item in the pricing and the risk margin is the driver of revenue in insurance companies. More guidance is needed on how to estimate risk margins reliably, because the margin relates to a hypothetical transaction. There is also a need to clarify how the proposed margin relates to the concepts used by the FASB in SFAS 157, and to clarify the relationship between risk margins and discount rates.
- (e) The notion of a service margin is unclear. The staff referred to a document posted on the IASB web site in October 2007. This gives the staff's responses to frequently asked questions on service margins.
- (f) Some SAC members opposed the recognition of day one gains. Others were not opposed but stressed the need for clear disclosure of any day one gains recognised. Some emphasised the need to coordinate the discussion of this issue with the project on revenue recognition.
- (g) Because insurance liabilities are rarely sold or transferred, some felt that current exit value is not relevant and cannot be determined reliably. Others felt that exit value is the appropriate measurement attribute for insurance liabilities.
- (h) In relation to policyholder behaviour and future premiums:
- IFRSs should form a cohesive book of standards. The IASB should not create special standards for particular industries. Expected consumer behaviour is not a tangible, but an intangible asset, and is not predictable.
 - There is no good solution for policyholder behaviour and future premiums. The project should address accounting for insurance contracts, not insurance liabilities. The proposed treatment differs from the treatment of core deposits of banks.
 - One approach to this problem would start by drawing analogies to pension plans and then thinking what has to be different for insurance contracts. A stochastic approach could be considered.
 - The term of an insurance contract is not always evident. The policyholder can stop the contract early.
- (i) In accounting for policyholder participation, it is important not to take too narrow a view of constructive obligations, but it is also important to coordinate the approach to this issue with the work on constructive obligations in IAS 37. Otherwise, insurers will not recognise at inception large profits that would not

reflect the economics. Policyholder participation systems vary greatly by country.

- (j) The measurement of insurance liabilities should not reflect their credit characteristics. Reflecting those characteristics would cause severe reputational risk for the IASB. It would also cause regulators to apply prudential filters that exclude such effects.
- (k) It is critical to determine how the performance statement would look.
- (l) Changes in the current value of insurance liabilities should not be recognised in profit or loss.
- (m) Insurers wish other industries had gone first in applying such a new model.
- (n) The project should avoid unnecessary divergence from the content of, and timetable for, the European Solvency 2 project.
- (o) It is important to develop guidance on accounting by policyholders, especially for emerging markets.
- (p) Accounting by the policyholder should be a mirror image of the accounting by the insurer.

Summary

- 8.3 Mr McGregor summarised the session. He highlighted SAC members' concerns that the project on insurance contracts may be leaping ahead of other contracts. He sensed general support for the building block approach, but some concerns about certain aspects of the building blocks. One of these aspects was the reliability of risk margins; on occasions without an existing market they will be difficult to estimate. Perhaps surprisingly, the debate about own credit risk had been brief, but he recognised that many had great concerns about this issue.
- 8.4 Mr McGregor also mentioned the issue of day one profit recognition and the need for appropriate disclosures on this. He reported the need to clarify what 'service margin' means and therefore includes. He thought that it may be better not to give a separate label for this margin. He referred to the question of market-participant or entity-specific estimates and the need for the measurement of the liability to reflect its characteristics (portfolio-specific cash flows). He noted that future policyholder behaviour may have implications for other issues, such as core deposits. He mentioned the recommendations by some SAC members not to go too far away from the model in IAS 18 and by others that settlement value could be a more useful notion than current exit value.
- 8.5 He had noted concerns that a very narrow view of constructive obligations could mean that the model may not really reflect the economics of insurance contracts. He reported the discussion about whether an insurance contract was a service contract or a financial instrument and the conclusion that it combines both elements. That brought up questions about the scope of the project and the linkage to other projects, such as revenue recognition and IAS 37. He highlighted the requests to consider the practicability of the models. He also registered the support for a policyholder accounting standard and for accounting by policyholders and insurers to be symmetrical.

- 8.6 David Lindsell, SAC member assigned by the SAC chairman to comment on the summary presented by the Board, added that the consequences for long-term business and deposit savings were mentioned. Mr Lindsell reminded that it is difficult to avoid deviation from other standards.

Meeting closure

- 8.7 Mr Jones thanked the SAC members for the very good session and appreciated their efforts. He confirmed that he is well aware that this is unpaid work and referred to the very high Board attendance to listen to the views expressed by SAC.

END