IASB
BOARD DECISIONS ON INTERNATIONAL ACCOUNTING STANDARDS
UPDATE
May 2002

The International Accounting Standards Board met in technical session in London, UK, 22 – 24 May 2002, when it discussed:

- Business combinations
- First-time application of IFRSs
- Insurance contracts
- Reporting performance
- Share-based payment

The IASB met its partner national standard-setters in London, on 20 and 21 May. The group discussed:

- Consolidation and special purpose entities
- Candidate topics or projects for convergence of accounting standards
- Recognition and discontinuing recognition: leasing, service concessions and related issues
- Reporting performance
- Revenue, liabilities and equity: definition of elements

No technical decisions were requested or made at this meeting. A full report of the group's discussions will be included in the next issue of *IASB Insight*.

Business combinations (phase I)

The Board completed its deliberations on phase I of its business combinations project at its meeting in April 2002. However, the process of drafting the Exposure Draft highlighted some additional issues relating to the subsequent recognition of, or changes in the values assigned to, the acquiree's identifiable assets, liabilities and contingent liabilities. The Board considered those issues and agreed that the IFRS replacing IAS 22 *Business Combinations* should include the following requirements:

- if either the amounts to be assigned to the identifiable assets, liabilities or contingent liabilities of the acquiree or to the cost of the business combination can be determined only on a provisional basis, the acquirer should initially account for the business combination using those provisional amounts. Any adjustments to those provisional amounts as a result of completing the initial accounting for the business combination should be made and recognised no later than twelve months from the acquisition date.
- adjustments to the initial accounting for a business combination after that accounting has been completed should be recognised only in order to correct an error as defined in [draft] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Adjustments to the initial accounting should not be recognised for the effect of changes in accounting estimates. The effect of a change in an accounting estimate should be recognised in current and future periods in accordance with IAS 8.

Business combinations (phase II)

This is a joint project with the US standard-setter (the Financial Accounting Standards Board (FASB)).

Value of large block of equity instruments

The Board considered the valuation of a large block of equity instruments. The fair value of a large block of equity instruments might differ from the market price of a single equity instrument multiplied by the number of equity instruments issued. Board members agreed that consideration of this issue should be deferred pending developments in both (a) a project of the American Institute of Certified Public Accountants' Accounting Standards Executive Committee addressing fair value and the blockage factor related to valuing unrestricted investments and (b) the IASB's Financial Instruments, 'Next Steps' project. The Board noted that although the guidance on measuring the effects of discounts or blockage factors on the fair value of equity instruments issued as consideration under the US FASB literature and under the IASB proposed amendments to IAS 39 *Financial Instruments: Recognition and Measurement* differs at present, in practice there are unlikely to be differences in the treatment of such factors.

Acquisition-related costs

The Board considered the accounting for acquisition-related costs incurred in a business combination. The IASB observed that the agreed working principle for phase II was based on the fair value measurement objective. Consistent with the decision of the FASB, the IASB concluded that acquisition-related costs are not part of the fair value of the exchange transaction with the former owners of the business acquired and, therefore, should be accounted for normally in accordance with their nature rather than being included in the cost of the business combination.

Restructuring provisions

In the light of discussion by the FASB, the IASB considered the treatment of restructuring provisions that were not liabilities of the acquiree immediately before the business combination. During the business combinations (phase I) project, the IASB considered the recognition of liabilities for terminating or reducing the activities of the acquiree that were not liabilities of the acquiree at the date of acquisition (at present, IAS 22 requires recognition in some circumstances). In October 2001, the

(continued...)

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IASB Publications Department, 7th Floor, 166 Fleet Street, London, EC4A 2DY United Kingdom
Tel: +44 (0)20 7427 5927
Fax: +44 (0)20 7353-0562
E-mail: publications@iasb.org.uk
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Business combinations (phase II) *(continued)*

Board agreed that liabilities for terminating or reducing the activities of the acquiree that were not liabilities of the acquiree at the date of acquisition should be included as part of the allocation of the cost of acquisition only when the acquiree has, as at the date of acquisition, an existing liability recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The IASB confirmed its phase I decisions relating to amounts that were not liabilities of the acquiree immediately before the business combination.

Post-employment benefit obligations triggered by a business combination

The Board considered the treatment of post-employment benefit obligations triggered by a business combination, given the decision reached by the FASB. The FASB agreed that these are obligations assumed in a business combination that should therefore be included as part of the allocation of the cost of acquisition. During phase I of the business combinations project, the IASB considered the recognition of liabilities whose triggering event is the business combination. As discussed in the preceding paragraph, the IASB had previously concluded that liabilities arising as a consequence of the business combination that were not liabilities of the acquiree immediately before the business combination should not be included as part of the apportionment of the cost of acquisition. Such obligations represent post-acquisition expenses of the combined entity and should, therefore, be recognised in the income statement of the combined entity. The IASB agreed to proceed with its phase I decisions relating to post-employment benefit obligations and other liabilities triggered by a business combination that were not liabilities of the acquiree immediately before the business combination.

The IASB and the FASB will reconsider this issue, along with any other issues on which initial agreement is not reached, with a view to reaching agreement on the appropriate accounting treatment, prior to the preparation of an exposure draft.

First-time application of IFRSs

The Board discussed the first-time application of International Financial Reporting Standards (IFRSs). This is a joint project with the French standard-setter (Conseil National de la Comptabilité (CNC)).

The Board agreed that an entity recognises the cumulative gains and losses on an available-for-sale financial asset in a separate component of equity in its opening IFRS balance sheet, rather than in retained earnings as the Board had originally concluded in March 2002. On subsequent disposal, those cumulative gains and losses are included in the gain or loss on disposal recognised in income. This is consistent with the transitional provisions is IAS 39 *Financial Instruments: Recognition and Measurement*.

The Board discussed the treatment of a subsidiary that has previously reported to its parent using IFRSs without preparing a full set of financial statements under IFRSs. If the subsidiary subsequently begins to prepare financial statements that contain an explicit and unreserved statement of compliance with IFRSs, it becomes a first-time adopter at that time. The Board agreed that the subsidiary should give the same disclosures as other first-time adopters. However, in some cases, the proposed Exposure Draft might result in measurements that differ from those reported to the parent and these differences could persist in the future. To avoid this, the Board agreed that the subsidiary should not be treated as a first-time adopter for recognition and measurement purposes if:

- its parent presents financial statements that contain an explicit and unreserved statement of compliance with IFRSs; and
- the subsidiary is a wholly-owned subsidiary or the owners of the minority interests, including those not otherwise entitled to vote, unanimously agree that the subsidiary is not treated as a first-time adopter for recognition and measurement purposes.

In previous discussions, the Board agreed various exemptions from the general proposal that a first-time adopter applies all IFRSs retrospectively. The Board agreed that it should not prevent full retrospective application. Accordingly:

- an entity should not be required to use the first-time application Standard. However, if an entity does not comply completely with retrospective application, it must use the first-time application Standard.
- if an entity does not use the first-time application Standard, it should apply the IFRSs that were in effect in each period and may, therefore, need to consider superseded versions of IFRSs if later versions have required prospective application. By contrast, if an entity uses the first-time application Standard, it should apply only the latest version of IFRSs.

In March 2002, the Board agreed that an entity's first IFRS financial statements should include, among other things, reconciliations of the equity and net profit or loss under IFRSs to the amounts reported in financial statements under previous GAAP. The Board clarified that these reconciliations should give sufficient detail to enable users to understand the material adjustments to the balance sheet and income statement. An entity should also explain the material adjustments to the cash flow statement.

The Board agreed to require similar reconciliations in an entity's interim financial report under IAS 34 *Interim Financial Reporting* for part of the annual period covered by its first IFRS financial statement:

- in each such interim financial report – reconciliations of the entity's (i) equity at the end of the comparable interim period of the immediately preceding financial year and (ii) net profit or loss for that period (current and year-to-date) under IFRSs to the amounts reported under previous GAAP; and
- in addition, in the first interim financial report under IAS 34 for part of that annual period – reconciliations of the equity and net profit or loss under IFRSs to amounts reported in the annual financial statements under previous GAAP.

On completing its discussion, the Board directed the staff to prepare an exposure draft for written ballot.

Insurance contracts

The Board discussed the timetable for the project on insurance contracts, in the light of the European Union's proposed requirement for all listed EU companies to prepare their consolidated financial statements using IFRSs from 2005. The Board noted that it would not be realistic to expect

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implementation of a full recognition and measurement standard for insurance contracts by 2005. Accordingly, the Board agreed to investigate whether the following components of the project could be put in place by 2005, without delaying the rest of the project:

- presentation and disclosure, including consideration of how insurers might give the disclosures about measurement assumptions proposed in the Exposure Draft of the improvements to IAS 1 *Presentation of Financial Statements*;
- application of IAS 39 *Financial Instruments: Recognition and Measurement* to some contracts issued by insurers that do not qualify as insurance contracts for accounting purposes;
- elimination of a limited number of existing practices that are incompatible with the IASB *Framework*, for example, the elimination of catastrophe and equalisation provisions that do not represent liabilities as defined in the *Framework*; and
- consideration of the implications for entities issuing insurance contracts of the hierarchy of pronouncements that an entity is required to consider in the absence of an IFRS that specifically applies to an item (see [draft] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, paragraphs 5 and 6).

The Board confirmed that it has no intention of exempting insurers from existing IFRSs (beyond the scope exclusions for insurance contracts in existing IFRSs such as IAS 18, 32, 37, 38 and 39).

The Board then discussed illustrations focusing on concerns that some Board members had expressed in previous discussions of the Draft Statement of Principles (DSOP) prepared by the former IASC Insurance Steering Committee. These concerns arose from the fact that the DSOP proposals could lead to the recognition of some gain or loss on initial recognition of an insurance contract. The illustrations included an accounting model with the following features:

- no amount of profit is recognised on initial recognition of the insurance contract. This is accomplished by changing the risk adjustment as necessary
- acquisition costs are not reported as assets in the balance sheet
- insurance liabilities are computed as present values
- profit attributed to the insurance contract is recognised over the period during which the insurer is at risk. That period includes both the premium period, during which insured events occur, and the claim-paying period after the close of the premium period.

After discussing the illustrations, the Board concluded that it would not pursue this model further at this time, and will continue its discussions of the model proposed in the DSOP.

The Board began a discussion of a staff paper on performance-linked contracts. The discussion was educational and no decisions were taken. The discussion will continue at a future meeting.

Reporting performance

The Board continued its discussion of a staff concepts paper on reporting performance and made the following provisional decisions. This is a joint project with the UK standard-setter (the Accounting Standards Board (ASB)).

Analysis of expenses by nature or function

The Board concluded that analysis by function on the face of the performance statement should be required. The Board decided not to define categories of functional expense but to leave these to the discretion of preparers.

It was noted that presentation by nature is required by existing standards for certain line items, such as depreciation of fixed assets. It was agreed that presentation by nature should not be required for all expenses.

The Board decided to prohibit mixed presentation. This arises when (for example) a presentation is mostly by function with the exception of a separate line item for depreciation, causing each of the functional costs to be understated to the extent of the unallocated depreciation.

However, the Board decided to allow, on the face of the statement, disaggregation of functional components by nature. For example, the total for cost of sales could be broken down into components such as materials and depreciation.

Discontinuing operations

The Board decided to require the presentation of discontinuing operations as a single line item within the performance statement with disaggregated disclosure in the footnotes.

Extraordinary, exceptional and unusual items

The Board decided that a separate category of reporting performance should not be defined for items such as 'extraordinary', 'exceptional', 'unusual', 'special' or 'abnormal'. An implication is that restructuring costs would no longer be reported as a separate component of performance.

In addition, the Board decided that performance statement components could be disaggregated at the discretion of management, in order that certain items can be highlighted. However, the Board decided to prohibit the aggregation of such items and the presentation of a profit before and after such items.

It was noted that the column of the proposed performance statement that reports estimate changes related to future periods captures many of the recognised income and expense items that might, under present practice, qualify for inclusion as extraordinary, exceptional or unusual. For example, this column includes goodwill impairment and gains or losses on disposals.

Revisions to estimates

The Board discussed performance reporting for estimate revisions, particularly in relation to provisions. The discussion was not conclusive and will be resumed.

The Board discussed the line item to be used for presenting differences between amounts initially recognised as accounts receivable and amounts actually received. It was agreed that, under a functional classification, such items should be reported under the expense category relating to debt collection. This might vary among entities.

Share-based payment

The Board discussed application and measurement issues relating to employee share purchase plans, share-based payment transactions with parties other than employees, repricing of options (and other changes in terms and conditions), and unlisted and newly-listed companies. It reached the following tentative conclusions, which are based upon the assumption that the IFRS would require a fair value measurement basis to be applied to all share-based payment transactions:

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- There should be no exemption from the IFRS for employee share purchase plans.
- The measurement principles applying to all share-based payment transactions should be as follows:
  - Transactions in which goods or services are received as consideration for the issue of equity instruments should be measured at the fair value of the goods or services received, or the fair value of the equity instruments issued (or to be issued), whichever is more readily determinable. For transactions measured at the fair value of the equity instruments issued (or to be issued), fair value should be estimated at grant date.
  - For transactions with parties other than employees, there should be a rebuttable presumption that the fair value of the goods or services received is more readily determinable. For transactions with employees, there should be a rebuttable presumption that the fair value of the equity instrument issued (or to be issued) is more readily determinable.
- Repricing of options (and other changes in terms and conditions), whether before or after vesting date, should be accounted for by recognising additional remuneration expense based upon the incremental value given on repricing (that is, the difference between the fair value of the repriced option and that of the original option, both estimated as at the date of repricing).

The Board discussed whether an unlisted entity that is unable to estimate reliably the fair value of the goods or services received should be permitted to use the minimum value method. The Board agreed that further advice on this issue should be requested from the project's Advisory Group.

The Board tentatively agreed that newly listed companies should not be permitted to use the minimum value method, and that the IFRS should give guidance on estimating the expected volatility of newly listed entities, similar to that contained in the US standard SFAS 123 *Accounting for Stock-based Compensation.*

The Board continued its discussions of vesting conditions, begun at its April 2002 meeting. The Board considered a worked example of its proposed approach, compared with the approach applied in SFAS 123. Under the Board's proposed approach, the grant date valuation of the options would take into account the existence of vesting conditions, with that valuation then applied to the services actually received. Some Board members expressed concerns about the approach proposed to adjust the grant date valuation, and the Board agreed to request further advice on this issue from the project's Advisory Group.

Meeting dates: May – December 2002

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

17 – 21 June – Berlin, Germany†

17 – 19 July

18 – 20 September, Norwalk, Connecticut, USA

23 – 29 October‡

12 – 16 November, Hong Kong SAR, China†

18 – 20 December

† Includes a meeting with the Standards Advisory Council

‡ Includes a meeting with partner national standard-setters

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