

July 2008  
No 2008-07

## Highlights

The Board took the following actions during its July 2008 meeting:

- it had a first discussion on a staff draft of an exposure draft of a standard on consolidations that is aimed at replacing IAS 27 and SIC 12;
- it formally decided to put liabilities and equity and de-recognition on its current agenda;
- it devoted four hours to re-deliberating the IFRS for private entities, but was more in a mood to withdraw concessions that extend them;
- it discussed revenue recognition and acknowledged that as it is now restricted to a customer consideration approach it is not substantially different from IAS 18 and IAS 11. It recognised that it was now necessary to consider scope exclusions;
- it discussed fair value measurement but agreed tentatively to retain the term fair value even though several members thought it did not help clarity;
- it started to debate papers on an exposure draft of a management commentary document;
- representatives of EFRAG gave another presentation of their liabilities and equity project

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## IASB meeting July 2008

### Standard-setting sessions

(Tom Jones was physically absent throughout this meeting: a maximum of 12 Board member votes were available, except during the Thursday afternoon session when Mr Jones participated by videolink from the FASB)

#### Tuesday 22 July 2008

##### AMENDMENTS TO IFRS 5

Nobu Kowanishi explained that the object of the session was to cover final sweep issues before issuing an exposure draft of amendments to IFRS 5. He added that the first issue in Paper 4 was the criteria for the definition of discontinued operations. This had been briefly discussed at the June Board meeting but no decision had been made. The staff recommendation was to include 'businesses' as defined in IFRS 3 that met the criteria to be held for sale in the definition of discontinued operations.

David Tweedie asked if anyone disagreed. They did not.

Mr Kowanishi noted that that agreement obviated the need to discuss question 2. Question 3 (paras 23-25) was whether there should be an additional requirement that an entity that qualified as held for sale should only be classified as a discontinued operation if the disposal were required by law or regulation. Did the Board agree that this should NOT be the case? (They appeared to).

Jim Leisenring said he did not disagree with the staff recommendation but not based on para 24. He thought that people knew what the law required. Bob Garnett suggested the reference was to the competition authorities not having made a determination. Mr Leisenring responded that if that was what it meant, they could not say that the operation was discontinued. They had to have met the other criteria. Gilbert Gélard remarked that the point was not to restrict it to what was required by law, but to allow that the company could decide.

Mr Kowanishi went on to question 4. He said the issue was that the FASB would be debating the same questions the next day. (They might reach different decisions on the earlier questions than those taken by the IASB. If that was the case, the staff wanted approval to go ahead with an exposure draft that explained both approaches rather than spend more time trying to eliminate them at this point)

Mary Barth said she disagreed with the staff recommendation. They had a slot for sweep issues on Friday: they should wait and see what the FASB said. They should not put out a converged standard with different conclusions. Mr Kowanishi replied that he thought the FASB would take the same view as the IASB and this question was just in case. Jim Leisenring asked the FASB staff (participating by videolink) if they had a view on that. The staff declined to be drawn.

The staff moved to question 5 where the recommendation was that an exemption from disclosures be provided for businesses that were classified as held for sale on

acquisition. Peter Clark suggested that this appeared to be an unnecessary cost and effort exemption, and he wondered if some disclosure was appropriate about the profits of the unit and the profit or loss on sale. Mr Leisenring replied that the business had not previously been owned by the parent and was not included in past performance. That was the logic of the exemption. (The Board appeared to agree the staff recommendation that exemptions be given to businesses that were held for sale on acquisition, and also with a list of exemptions – para33).

Mr Kowanishi said there was one further issue that had come in overnight and was in paper 4A. This was an issue raised by FASB members at their educational session: the amounts disclosed in the notes would not reconcile to those on the face of the financial statements. The staff outlined circumstances where this might be the case and recommended additional disclosure requirements. The Board agreed.

## INCOME TAXES

Anne McGeachin reminded the Board she had distributed a pre-ballot draft of the exposure draft of an amendment to IAS 12 in May. Today's paper consisted of sweep issues that Board members had raised. (Jim Leisenring noticed there was no-one manning the FASB desk on the videolink and asked if the FASB were not participating in this project – someone went to call the FASB to tell them the previous session had finished early.)

Ms McGeachin told the Board that discussing the paper at this meeting kept them in line with the latest Techplan. She said the first question did not concern the FASB as such. Did any Board member wish to express alternative views in the exposure draft? David Tweedie said that he would like to. Mary Barth added, but he would not do it. Bob Garnett remarked that for him it depended on what the document was finally going to say. As they went through he might realise that what he had agreed to was not what was actually going in. Warren McGregor had a different view on what some of these meant.

### Format issues

Ms McGeachin noted that the first few issues were to do with format. The first was whether the revised standard should be a new IFRS or a revised IAS 12. The staff recommendation was to stay with IAS 12 since the basic approach had not been changed. Mr Garnett replied that they had changed the wording and the format. He thought that had changed enough to be an IFRS. Mr McGregor agreed. Philippe Danjou observed that IFRS 8 had replaced an IAS. What were the criteria? The chairman asked who would rather have an IFRS. There were seven votes in favour. Mr Gélard observed that they would look more productive.

Ms McGeachin moved to the next question on whether the exposure draft should eliminate questions that the FASB were asking about amendments to SFAS 109 that had no counterpart in IAS 12. The Board agreed.

Ms McGeachin reminded the Board that the draft was organised with the main requirements in the standard and details in application guidance. Examples were in implementation guidance outside the standard. Some feedback had suggested that

some of the implementation guidance should be in the application guidance. She was reluctant to change things because she thought the standard gave a better overview without the application detail.

Wei-Guo Zhang observed that in other projects staff seemed happy enough to put examples in the text, but in this one she was suggesting the examples should be in an education document. Ms McGeachin agreed she had suggested in the cover note that the implementation guidance might be published as an education document. There was not anything new in that. Ms Barth observed that the Board's criterion was if the examples were necessary to understand the issue they should be in the application guidance. Were these examples necessary? Ms McGeachin answered that the subject raised had been in the area of tax bases. She knew that people would find an example of inter-period tax allocation helpful, but in general this should not need examples in the standard. Mr Yamada disagreed. He said that he sometimes found the text incomprehensible and it was only through an example that he could understand. They also did not know when the educational material would be issued.

Mr Leisenring accepted that you could not disagree with the principle that the standard *should* be understandable but they did not always achieve that. What he found more mind-numbing was it was against policy to cross-reference to implementation guidance. They were saying they were going to give people an example to help them understand, but they were not going to tell them what they were explaining. Mary Barth observed that she did not find that offensive – she did not want cross references to educational material in the standard. Alan Teixeira added that in some jurisdictions the fact of giving a cross-reference would bring the example into the legislation. Mr Upton confirmed that the last time they had discussed this, the issue was that if you referred outward to an example, it brought the example in. However, if you referred inward from the educational material to the standard there was no problem.

Ms McGeachin moved on to paras 19/20: she explained that as regards tax relating to equity instruments the tax basis would be the same as the carrying amount. Mr Leisenring clarified that this was instruments issued by the entity, not held.

#### Foreign subsidiaries

Ms McGeachin went on to an exception from SFAS 109. There was an issue as to what threshold they wanted to apply to this exception. Those in SFAS 109 applied differently to deferred tax assets and deferred tax liabilities. Her recommendation was that they should stay with the same threshold which is understood in practice, but the wording would be 'essentially permanent in duration' for liabilities, and 'temporary differences not expected to reduce in the near future' for assets (para 29).

Mr Gélard commented that it should be 'reverse' not 'reduce'. Ms McGeachin replied that some Board members did not like 'reverse'. Mr Gélard observed that inventiveness in language was not a good thing for the Board.

Mr Leisenring agreed that if this was very short term, it did go away, but duration was not the issue, it was that you could not do it. He did not mind using the same language but it was not the same issue. Ms McGeachin observed that the exception in SFAS

109 for subsidiaries and joint ventures applied to deferred tax assets if they were not expected to reverse in the future. Mr Leisenring responded that it was not because of time but because they could not demonstrate realisation. Mr McGregor remarked that when they had had the meeting with the tax experts he had thought it was because it was all so difficult, and we would give the same exception. Ms McGeachin thought it was not clear that the FASB wording reflected the reason for the exception. Ms Barth said the issue was how did they word the exception.

Mr Garnett noted that he thought this was an exception to an exception. They only got it if they did not distribute earnings. The tax experts had told them that they did not do the tax planning unless they intended to distribute a dividend. Mr Upton added that if you had \$100m undistributed and you decided to distribute \$100,000 there was no tax effect on what was not distributed. The FASB staff agreed that was their understanding. It would be applied proportionately. Mr Leisenring objected that the words 'permanent in duration' was based on periods beyond when you could forecast. The FASB staff said they looked further ahead for deferred tax liabilities than for deferred tax assets.

Mr Garnett said the wording of para 24 of the paper (omitted from observer notes) was part of the reason for the apoplectic reaction at his end of the room. It said that no earnings would ever be remitted. Mr McGregor also disagreed with the wording. He thought they were giving foreign subsidiaries and joint ventures a by, but if they paid a dividend, they had to account for the deferred tax liability. To the extent of the distribution, added David Tweedie. Ms Barth said the good news for the staff was that Messrs Garnett and McGregor would help with the drafting. The chairman asked if they agreed with the principle.

Jim Leisenring asked for clarification that it was not a requirement that you did not provide for deferred tax liabilities on foreign earnings. The FASB staff said you had to make an election not to provide deferred tax. Mr Leisenring added that if he was the CFO of a multinational and wanted to repatriate \$1bn of past earnings he would not want a deferred tax charge of \$400m. He thought that many CFOs tax effected the earnings systematically to avoid that problem.

Mr Leisenring wanted to know what the assets were different. Ms McGeachin said they were in SFAS 109 not APB 34. She suggested they only looked to see if it was likely to reverse in the foreseeable future, which was taken to be one year. The FASB said that what they had heard from the specialist group was that the entity had asserted that the investment was permanent. If they were in an asset position they could lose the permanent status. Tax would still not be provided unless they would reverse within one year.

Mr McGregor asked why they had a different test. Ms Barth explained he was saying that they had a different test for a tax asset loss elsewhere in the standard. Mr McGregor said they should use the same test. David Tweedie clarified that this was 'more likely than not'.

Ms McGeachin went on to the issue of what happened when an entity ceased to be a subsidiary. She suggested they should stick with IFRS 3. Nobody disagreed

## Other issues

She moved onto inter-period tax allocations. She reported that the last draft had included the SFAS 109 requirements on allocation but this had been re-worded. However, many people found it too difficult to understand. The FASB staff had reported that the US experts found it easier than SFAS 109 and that the staff had not changed the meaning in any way. The accounting firms' handbooks had very long chapters on these rules. She did not think they could change the wording without risking changing the requirements. Did they want to follow SFAS 109?

Mr Leisenring remarked that they had done this with financial statement presentation and income tax. They had said they would follow the US and then changed their minds. Ms McGeachin added that there were gaps in IAS 12 which were being interpreted in various ways. The chairman asked if she was worried about what SFAS 109 was trying to do. She replied that in some places it was impossible to understand. Mr Leisenring noted that the US standard was easy to apply in 95% of cases, the difficulties arose when there were several issues such as a tax rate change, discontinued operations etc that occurred together. It became a mush.

Bob Garnett pointed out that the US tax system was one of the most complex in the world. Once you moved out of consolidated tax and back to individual companies it became simple. They should say that if you can separate out the different entities you should do that. For people not familiar with the US requirements the standard might seem difficult. David Tweedie suggested they ask a question, noting that this could be done in some jurisdictions, and asking if they should cover it.

They moved on to substantive enactments. Ms McGeachin noted that substantive enactment occurred when future events required by the enactment process would not change the outcome. The Board had said 'will not' change, and the staff thought they should explain that did not mean 'can not' change the outcome. Did they agree with providing extra guidance? They did.

Bob Garnett suggested they should not say 'highly unlikely' (para 38) but only 'unlikely' as the former would be taken to mean never.

Ms McGeachin reported that the draft said that national standard-setters could give guidance on the application of the standard in their jurisdiction. Some Board members had objected to that. Warren McGregor remarked that they should not encourage jurisdictions to issue their own interpretations. Mr Leisenring added they were giving away the franchise. Philippe Danjou asked where they would stop if they did it in this standard. The chairman asked if the Board agreed the staff recommendation of putting something in the Basis for Conclusions. They did not.

The next subject was disclosures of deferred tax. Ms McGeachin said the aim was to give a reconciliation between total tax expense and current tax expense (paras 40/41). Some staff had observed that the wording did not specify a numerical presentation. This had been changed. Some people thought the disclosure was too detailed.

Philippe Danjou was doubtful about how practical it was to provide this level of detail. The staff pointed out that IAS 12 already required disclosures by type and tax

loss. They had also to give total figures and it did not look as though this was adding much. The Board agreed the staff recommendation. They also agreed on a disclosure of the tax effect of future distributions.

Ms McGeachin moved on to disclosures relating to tax uncertainties. The uncertainties were reflected in the measurement. The disclosures proposed in the ED were the same as for IAS 37. What they did not ask for, by comparison with those in FIN 48, was a disclosure of the difference between what had been recognised and what had been claimed. The staff recommendation was not to change this.

Steve Cooper remarked that he would like to see something about the range of possible outcomes. FIN 48 provided that. David Tweedie remarked in the silence that followed that there did not seem to be much support for that change.

Ms McGeachin moved on to the treatment of temporary differences. One reader wanted the staff to try to clarify the wording. The problem was that there was no home for this. The staff had decided to create 'purchase discount' and 'purchase premium' which were then treated the same as deferred tax. It usually happened that there was mis-measurement and this have anomalous results but they did not see any way to deal with this. Warren McGregor added that this arose in a business combination because tax was not measured on a fair value basis. Jim Leisenring observed they had spent God knows how many meetings saying there was nothing else to do with it. Mary Barth suggested they move to the next issue.

The staff moved to para 75 and the role of expectations. The tax basis was set up as a matter of fact but in measuring deferred tax expectations did come into account. Some Board members thought this was confusing. The draft came as near to US GAAP as the staff had been able to articulate, and they recommended not changing it.

They moved forward to the recognition and measurement of deferred tax assets. Some subject experts were confused between recognition and measurement and the role of uncertainty. The approach was that recognition was when a deduction was possible, and measurement reflected the likelihood of receiving it. The staff would try to improve the wording. The Board agreed.

Ms McGeachin noted that some constituents had asked whether the Board would consider discounting for unused tax losses and tax credits. The staff recommendation was that this should not be added to the project, but some Board members wanted it in. Mr Leisenring observed that the only way you could discount would be if you knew when the differences would reverse. They could only do it if they imposed scheduling. Mr Cooper said he would love to see a requirement that gave investors some idea of what the tax asset was worth. The Board agreed the staff recommendation.

The staff moved to allocation of the effect of changes in uncertain tax positions. Ms McGeachin said that FIN 48 treated a change as a recognition of new elements and allocated the effects to different parts of the income statement and OCI. The staff thought changes should not be tracked backwards and they should be recognised in continuing operations. The IASB requirements on uncertainty were not the same as SFAS 109. However it was all completely arbitrary. Wayne Upton noted that the

approaches were completely different in concept. David Tweedie suggested they should ask in the ED whether they should change.

Ms McGeachin moved to interest and penalties. The ED said that the entity should make its own policy decision as to how to report tax penalties and interest. One Board member disagreed. Mr Leisenring said he had not raised the issue, but the expense was either operating or financing, but it was not tax. Other Board members were less sure. The chairman called for a vote which was 7-5 for the staff recommendation.

The last issue was transition. Ms McGeachin reported that people who adopted IFRS before the new standard was issued would have to adopt the old IAS 12. The Canadian standard-setter had raised the issue, pointing out that they might have to adopt the old standard for one year. Mr Garnett said he was not sure that he agreed. If the effective date of the new standard was 2011, they would use it for 2011 and the comparatives. Warren McGregor asked when the standard was likely to be issued if all went swimmingly. The staff replied 2010. Board members thought that the pre-ballot draft was in effect amending IFRS 1, and if that was omitted the normal provisions of IFRS 1 would take care of the situation. They agreed that the special transitional arrangements should be taken out of the draft.

## REVENUE RECOGNITION

Henry Rees introduced Jeff Wilks and other FASB staff who were participating by videolink. There were two papers to discuss, he would present the first, and communications permitting, Jeff Wilks would present the second.

### Completing the project

Paper 6A set out the optimal timetable for completing the project, and this was being submitted for Board approval. There were three proposals: (1) to issue a discussion paper in October/November; (2) to start drafting the exposure draft; and (3) setting June 2011 as the deadline for completion.

### *Discussion paper*

The staff had discussed whether a discussion paper (DP) was still needed. They had decided that it was still useful: an approach based on a single contract was a major change in some areas. Mr McGregor asked if the staff had any idea how pervasive a problem this might be. Mr Rees replied that comment letters on what had become IFRIC 15 had led them to believe that constituents would have something to say. Another thing was that customer consideration was largely familiar but the Board was proposing to allow the use of estimated stand-alone prices. That was a big change for the US. The staff thought it would be useful to receive feedback on the measurement issues. The questions for the Board were after para 29.

Jim Leisenring agreed that a DP should be issued – but not this one. He did not think a DP was necessary given what the Board had done. He had heard a question at the FASB as to whether this was just a paper on cost allocation. He was surprised they talked only about contracts. Mr Rees said they had discussed using ‘arrangement’ but

thought that was too broad. They meant promises that were enforceable. Mr Leisenring thought that ‘contract’ would be translated very narrowly in the US. Mr Rees said they could put words around it.

Mr Leisenring observed they were putting this out after nine years (comments of seven) of work. It was not dealing with commodities. He did not think customer contracts had been particularly problematical but they were being tightened up and areas were being loosened where there was a hell of a problem (where there were no specific prices). They had no robust definition of onerous contracts. He would not issue a DP.

John Smith observed that they needed to get the subject out of the way. Warren McGregor said he had similar concerns to Mr Leisenring. However they risked having to re-expose if they issued it directly as an exposure draft. On construction contracts they were saying move from an economic activity approach to an economic delivery approach – what for? Mr Leisenring interjected that the list of unresolved issues was dramatically more significant.

Tatsumi Yamada said he agreed with issuing a DP but they should clearly articulate that this was not comprehensive. Focussing on just the recognition issue was too narrow. Mr Rees replied that in the US they did have different recognition principles. People said the US had 200 pieces of literature on revenue recognition, but actually the IASB had 40 pieces. Their analysis was there were four principles types: the first was outside of a contractual relationship, the second was measurement only when cash had been collected, the third was continuous recognition and the fourth recognition on sale. They had to show how this approach lined up. They had to get people to accept a single recognition principle. Mr Yamada said they should think of the rest of the world, they were not just setting standards for the US.

Mr Danjou said he would like to know that IFRIC 15 was not directionally different from this. Mr Rees answered that he thought it was consistent with this, but IFRIC could not change IAS 11. Contracts with continuous transfer would change.

Mr Garnett noted that his initial reaction had been to go straight to an ED – there was nothing earth-shattering about this. However, he was mindful of the construction industry. He thought that a six month exposure period with round tables inside that period would be more helpful. He thought they needed to distinguish between revenue from sales and the construction of assets that you hope will sell. Jan Engström said he would like to see them focus on what problems they had and whether they were solving them.

John Smith asked how many of Mr Rees’s 40 pieces of literature would be affected by this. Mr Rees said that when you looked at the 200 pieces of literature in the US, many would not be on what the IASB would consider to be revenue. The IASB equivalent would include IAS 16, IAS 37 and IAS 38 for example. The 40 number was just off the top of his head.

Wei-Guo Zhang asked if they were aiming for a single standard. He thought it was hard if they wanted to integrate all industries. Jeff Wilks agreed that it had occurred to the FASB that certain industries might be scoped out – such as leasing, commodities.

Warren McGregor thought they should be careful what they said: they would set some rabbits running. It should be clear that insurance was scoped out.

Mr Leisenring said he was astonished to hear at the FASB meeting that accounting for contracts did not include financial instruments. Mr Rees responded that he thought they were saying that anything covered in a specific standard would not be covered by the general recognition contract. Mr Leisenring said he did not get the idea from the FASB discussion that there was any common idea what the scope of this standard was. He had heard one member say this would affect companies that deferred costs and revenue at the moment. Mr Rees agreed that certain standards allowed one to recognise revenue up front because of costs. This document said you could only do this if service was provided. Mr Wilks said it might appear that they had been derelict about the scope issue, but until they settled on the customer consideration approach, the other approach dealt with these issues. Only since the May decision did they need to reflect on the scope.

Mr Yamada went back to the point about round tables. He was not sure about the sequence DP, round tables, field visits, exposure draft. They needed input earlier on some issues. Mr Rees said the field visits would be going on during the DP exposure period. John Smith asked if the measurement issue would be addressed. They needed to get some input on how this approach worked with different industries. Mr Rees said there should also be a comprehensive discussion of the fair value approach in the measurement chapter. Mr Leisenring said they could not ask constituents to go on a fishing expedition for them. They would say the Board members were the guys that got the big bucks for sorting these things out. Mr Smith observed that Mr Leisenring was saying they had spent seven years on this, but when they voted, he did not like either model. He had not told them what he did like.

David Tweedie said they needed to address the arrangement v. contract issue and also discuss the scope. What rationale was the staff going to give for the areas they missed out (given in the end of the paper). Mr Rees replied that they thought it was useful to get feedback on the concept of recognising revenue. They would have a lot more to figure out when writing the standard. They would flesh that out at the exposure draft stage.

Philippe Danjou Observed that although they were going directly to the customer consideration approach, they had said they would also mention the other model. Mr Rees replied that that depended on whether you thought the early part of the next paper constituted setting out the other model. He thought it was very difficult to explain the model in full detail because it highlighted issues with the customer consideration model. The Board had not wanted constituents to have to work through the other model.

David Tweedie asked for a vote on whether to issue a DP. This was agreed 11-1 (Jim Leisenring).

He asked about having a six month comment period including round tables. Mr Garnett said he thought it would be more productive to engage with people at an earlier stage so that they could write considered comment letters afterwards. They did not have a working group on this topic. Mr Rees said that they had planned targeted

outreach activities to areas that would be affected by this. He thought they needed a six month comment period and round tables at the exposure draft stage. David Tweedie called a vote on a four month comment period on the DP and six months on the ED. This was lost 5-6. The chairman asked what that did to the timetable. Mr Rees said they would try to get the DP out fairly quickly. Ms Barth asked if they could reduce the time by moving the round tables. Mr Rees said that if people disagreed with the general principle the timetable was not possible anyway. There would be more useful interaction at the ED stage.

Mr McGregor thought they would get value from round tables at the DP stage. Peter Clark observed that they were not committing to round tables at this stage. They were there as a contingency. Mr McGregor said he had lots of feedback on this project from his constituency. They were going to want to talk this through face to face. Mr Smith observed that the paper was very high level and they were going to get a lot of feedback asking what were the implications for particular industries. Mr Rees said he hoped they would get some feedback from the outreach programme. They had spent six years discussing measurement, they had not spent six years trying to resolve the other issues. He was not saying they were going to be easy. He said he assumed that the Board wanted a six month exposure period for the DP.

#### *Approach to the ED*

Mr Rees said they would try to proceed straight away to drafting the ED. They would identify what issues needed to be addressed and highlight where the current literature could help. That did not mean that constituent input would be ignored. The timetable was set out in paras 43 and 44.

Mr Leisenring observed that there were things in the timetable that were to do with IAS 37. Mr Rees responded that IAS 37 picked up warranties that people had not dealt with as a separate deliverable. Mr Yamada asked for confirmation that the project dealt with contract related liabilities. Mr Rees said that IAS 37 dealt with some revenue issues at the moment. Mr McGregor took the view that they should think about discussing scope up front. Mr Leisenring asked when they were going to discuss what was a separable performance obligation. Staff said December 2008.

David Tweedie asked if they agreed with what was proposed (Yes) and the time table – plus two months. (Yes)

Tatsumi Yamada asked how they would educate the new Board members. David Tweedie said that would be Mr Yamada's job. John Smith suggested that they might get smarter Board members. Mr Rees acknowledged that the timetable was challenging but said they did want to avoid the new adopters having to adopt IAS 18.

#### Measurement of performance obligations

David Tweedie said this was their last chance to beat up on Jeff Wilks. Mr Wilks said the paper tried to summarise the May decisions and clarify when they wanted to re-measure. They had agreed they would do that when the contract was onerous. The first point was that measurement at inception was at contract price. There were two

different views that arrived at the same conclusion. Did the Board think that paras 5-9 captured the process.

Jim Leisenring said paper 6A had said they did not know how to measure the rights, but 6B said they did. Assigning the customer consideration number was not the same thing as measuring the rights. Warren McGregor observed that if they were going to talk about measuring the assets and liabilities, then there was a view C which was that there was the possibility that there was an asset at inception. It was not an asset and liability model in complete form. Henry Rees said that view B acknowledged that there was a different way of looking at it, but for practical reasons this was not being pursued. Ms Barth remarked that a DP had to present all views. Board members could not dissent from a DP. Mr Rees said that discussion had to come in here. Mr Leisenring said they owed the world an explanation of why they took this view here but not for financial instruments.

Peter Clark said they were asking the holders of the majority view whether this document reflected their view. The minority view would be explained elsewhere.

David Tweedie asked who agreed with question 1 (the description of the measurement approach). This passed, 9-3 in favour. Questions 2 and 3 (paper reflected both views, and both should be included) were also agreed.

Mr Wilks moved on to the allocation approach in the paper. The staff recommended that the Boards did not apply an exception for level 1 exit prices when measuring performance obligations. He could think of very few transactions outside of financial instruments where such prices were available. They might well be scoped out anyway. Mr Leisenring thought you could not say (para 24) that there was no useful information if the exception were given. That was not what they did with financial instruments or a mortgage servicing contract. Mary Barth remarked that she and Mr McGregor had been saying that for some time.

John Smith said he had concerns about the commodity price (para 22). It seemed to be front-loading the contract. Steve Cooper said he did not see the point of going through the observed selling price of the machine and the installation. Why not just measure the price of the installation? (Mary Barth said: welcome to the fair value team). Mr Cooper also objecting to allocating on the basis of total labour costs. He would have preferred a margin approach. Mr Wilks said it sounded as though he had extended the exception to level 2.

David Tweedie said they would have to close. He asked for a vote. He asked who would be in favour of allowing commodities to be at fair value. There appeared to be 6 in favour (but it became clear the next day that this had been deemed to be approved). Who would go to level 2? 3 in favour.

Mr Wilks said they did not need to answer questions 5 and 6. Mr Leisenring noted that the FASB approach to inventory and that of the IASB were quite different. The FASB included a margin, IASB did not. If the revenue was related to that there was going to be a problem. David Tweedie suggested they would carry on the next day for half an hour.

Wednesday 23 July 2008

## IFRS FOR PRIVATE ENTITIES

Paul Pacter told the Board they were continuing the re-deliberation of recognition and measurement and presentation of the ED of the IFRS for private entities. In May they had discussed general issues and issues related to sections 1-3, in June they had dealt with issues related to sections 4-12 and would that morning be carrying on with the remaining sections. The next day they would deal with disclosure (Mr McGregor said he could not wait). The paper would be introduced by Michelle Fisher.

Ms Fisher said section 13 dealt with accounting for associates and joint ventures. Issue 13.1 was that the most frequent comment from respondents was that there were too many options. There were various proposals for dealing with this, and these were set out in para 6 of the paper. The staff recommendation was that the standard should retain the cost method. It was an appropriate simplification and there was no information loss. It would be premature to start prohibiting the equity method and proportional consolidation as they were still available in the main standards.

Warren McGregor acknowledged that they had said they should keep all options, but discussions on IAS 31 were at an advanced stage. They had agreed to drop proportional consolidation. The staff were doing further work on the standard but he thought they should drop proportional consolidation in this standard. Steve Cooper remarked that they would be removing it for all currently defined joint ventures whereas the new standard introduced a different approach. They could not remove proportional consolidation without introducing the new approaches. Mr Gélard agreed it could not be done.

Mr McGregor responded that the private entity standard was going out this year and then could not be changed for two years. It was going to be a long wait. If the joint venture standard was also going to be issued in 2008, why not include it. Philippe Danjou thought they should not anticipate the joint venture standard. They did not do it for other things. Mr Leisenring thought that if they got the joint ventures done they could then decide whether to incorporate it. If not, this was not unique, it was just the first occurrence of a problem they were going to have to live with in perpetuity.

Mary Barth thought that the Board's position was that it was *not* going to wait for final standards. That was not what they had done with the conceptual framework. Tatsumi Yamada said that was also his reaction, but he was not sure they could finalise IAS 31 as they proposed: there had been some cautious reactions to it. They should re-visit the SME standard if they finalised IAS 31. Gilbert Gélard thought that the framework was not a convincing argument, it was not at the same level. Mr Zhang said he was not sure he wanted to preclude anything. Mr Pacter commented that his recollection was that they had said they would not anticipate standards when in the middle of a project, but they had not discussed the situation when the standard was nearly finished.

David Tweedie asked if it would be acceptable that they went ahead on the current basis and if they finished IAS 31 in time they would come back on it.

Jim Leisenring went on to say he did not think the cost method was ever relevant, but what was the impairment that would be appropriate? Mr Pacter said the impairment section covered everything except financial instruments that were in section 11. Mr Leisenring asked if that covered shares in a public company when the share value was readily available? They must use consistent reasoning, it could not be that the information was not readily available. Mr Pacter said the draft was clear you had to impair a cost-based investment. On the second point that was a Board decision. Did they want to require fair value (Mr Leisenring added: or equity) for a public company.

Mr Garnett said he hoped the entity would disclose fair value. He would be careful about requiring them to account for it at fair value because that was not available in the big book. Mr Leisenring said he was just arguing against the use of cost. Mr Garnett said they were adding complexity to the rules.

David Tweedie asked who would allow cost. 7 voted in favour. Mr Garnett pointed out that the ED already required disclosure of fair value if the equity was listed. The chairman took a fresh vote on whether, if the investee was listed the investor should use fair value or equity. This was passed 8-4. Paul Pacter said his understanding was that all methods were retained but if the investee was listed the investor could not use cost.

Ms Fisher introduced topic 13.2. She said that IAS 28 was available by cross-reference. Where there was a difference in reporting dates between investor and investee it must be no more than three months. Comment letters had said it should be longer. The staff recommendation was not to change this. The cost method was available as relief.

Mr Leisenring said they were just driving people to cost, because it was a policy choice that affected all associates. Mr Pacter objected that it was the Board that had said it did not want pick and choose policies for investments. Mr Leisenring suggested they relax the requirement to six months. Mr Danjou said he could go along with the staff recommendation, but he did not think drawing a line was good. Why did they not refer to a principle – the data must be near to the situation at balance sheet date. He thought that was part of IAS 27 and IAS 28. Mr Pacter said he did not want to go away from the current standard.

Jim Leisenring said there was a limit to what he could tolerate (laughter). To say it would be impossible to move from three months to six but not to account for deferred taxes...David Tweedie responded that that was a mis-statement. There was no limit to Mr Leisenring's intolerance. Mr Garnett said he agreed with Mr Danjou (which was worrying) the principle was that the accounting periods should be consistent and that adjustments were made for any major differences that had occurred in the interim.

David Tweedie called for a vote. There were three in favour of the staff recommendation and eight in favour of what was called the Danjou principle approach.

Ms Fisher said that issue 15.1 was to respond to comments that there should be an option fair value investment property through equity. The staff did not support this:

entities could always use the cost option and disclose fair value. The Board agreed the staff recommendation.

A related proposal (15.2) was that the Board should remove the fair value option for investment properties. The staff thought both cost and fair value should be retained. The Board agreed. Issue 15.3 was that property held under an operating lease could be classified as an investment property. Some commentators had suggested this should be abandoned. The staff recommended retaining it. The Board agreed.

An issue (15.4) had arisen from the field tests. Preparers thought that separating mixed use property between investment and property plant and equipment was burdensome. The staff recommended there should be no change. The Board agreed.

Ms Fisher moved on to the next section, property, plant and equipment. Issue 16.1 was that some comment letters had suggested they should not require component depreciation, or at least leave it as an option. Many assets held by SMEs had a common use pattern. The staff recommendation was to retain the principle but to re-write that part of the standard to clarify it.

Ms Barth said she had some editorial comments. The re-write should talk about the rate of consumption of economic benefits, not the rate of depreciation, as that was what they were trying to decide. Philippe Danjou asked what if different components had different residual values. Mr Gélard said it would make no difference. Mr Zhang asked why the comment letters were against it. Mr Pacter replied that local GAAP mostly did not have the concept of component depreciation. They looked at the way the standard is written so we have turned it round to say the presumption is that the asset has a common consumption pattern. Mr Gélard said he had an example of where a company had a factory constructed on a turn key basis: it had no data to enable it to assess the value of the components.

Ms Fisher said that issue 16.2 was that respondents thought the standard should not require an annual review of residual value, useful life and depreciation rate or only require a review of any evidence for change. The review of residual value seemed more of an issue than useful life and rate. The staff recommendation was to say that they should review these only if there was an indication that the residual value has changed.

Mr McGregor noted that with impairment they gave examples of what indicators might be. Mr Pacter elaborated that companies thought this meant they had to obtain specialist valuation advice. Mr Leisenring queried that they would hire somebody to tell them what the residual value of a machine would be in 25 years. He would not spend a lot of his money on that. Mr Garnett observed that people were doing this for the first time. There was also a materiality question. Ms Barth agreed they did not have literally to do it every year.

Mr Pacter suggested that most SMEs followed tax depreciation and that mostly did not use residual values, or just provided a schedule. He thought the idea of having a residual value was a shock. They were going to say the entity did not have to do an annual calculation unless there was an indication.

David Tweedie asked if they agreed the staff recommendation, with the addition of indicators. They did.

Ms Fisher said that issue 16.3 was a proposal that SMEs should not have the option to revalue property, plant and equipment. The staff thought both models should be available. If the jurisdiction had concerns about the quality of the information, they could always limit entities to cost.

Mr Leisenring remarked that they should not allow revaluation without providing for deferred tax. The chairman said they should ignore deferred tax for the moment. Did they agree the staff recommendation? They did.

Ms Barth thought that the possibility of the local jurisdiction removing the option should not be mentioned in the Basis for Conclusions. It had not been a factor in her decision. Mr Pacter said that when they discussed the principle of allowing options they had argued that jurisdictions could remove them. It was in the draft Basis for Conclusions as part of the rationale for keeping the options. Mr McGregor thought they should not keep that reference. Mr Gélard thought it was valid as a general principle but should not be related to specific options. They had said that at the beginning. Mr Danjou remarked that they should not encourage people to change standards. The chairman asked if everyone agreed it should be removed – they did.

Ms Fisher reported that comment letters had asked for an undue cost or effort exemption to be available in respect of the obligation to separate the value of land from that of buildings (issue 16.4). The staff recommendation was not to provide this. (The Board agreed). Feedback during field testing had suggested that entities did not think that it was useful to capitalise maintenance costs where these enhanced capacity (issue 16.5). The staff believed no change should be made, but possibly further guidance could be given.

Moving on to intangible assets, Ms Fisher pointed out that intangibles generally were amortised over the period of their useful life, although this excluded goodwill. 18 comment letters supported the amortisation of all intangibles, including goodwill. The working group was also in favour of this. The staff recommendation was that all intangibles should be amortised over a maximum of ten years, while remaining subject to impairment. They believed SMEs were unlikely to have many intangibles with an indefinite life. The information was thought to be less reliable.

Mary Barth said she disagreed with the staff. They were turning back the clock. Warren McGregor thought it could not be justified on a cost/benefit basis. They were adding complexity. Was it based on user needs? They had been told that users disregarded amortisation and preferred impairment. Mr Pacter told the Board that they had actually taken a vote in the working group and it had been 40-0. As regards user needs, the banks in the working group said they would add back amortisation but they would not anyway lend against an intangible asset. The other issue was the fear of non-compliance if there was an impairment approach – SMEs did not see it. Jan Engström said they had put the question to users: they were strongly in favour of the staff recommendation. It was more a question of simplification.

Philippe Danjou said that 5% of companies that produced champagne were listed and 95% would use the IFRS for private entities. The 5% had large value brands on their balance sheets – should the other 95% amortise over 10 years? Mr Leisenring thought that people had always preferred amortisation to avoid having to think about impairment. He did not get the argument that SMEs did not have significant indefinite life intangibles. What about franchises? Mr Cooper disagreed with the proposal on the grounds that Mr Danjou had set out. He thought most intangibles arose from business combinations and there was relief in the standard from recognising separate intangibles.

David Tweedie put the staff recommendation, which attracted only 2 positive votes.

Ms Fisher went to issue 17.2, which was the capitalisation of development costs. She said that some comment letters thought that SMEs should expense development costs while others thought capitalisation should be compulsory. The staff recommendation was to retain capitalisation on an optional basis. (The Board agreed)

She said that issue 17.3 was the annual review of the amortisation period and method. Respondents thought this should not be required. The staff thought this should be retained but the wording changed to clarify that this was where there was an indication of change. (The Board agreed).

Issue 17.4 was a suggestion that revaluation should not be permitted for SMEs. The staff did not recommend this. (The Board agreed with the staff.)

Moving to goodwill, she said that issue 18.1 was the amortisation of goodwill. There was strong support for this and the staff recommendation was that it should be allowed. David Tweedie said he was more sympathetic on this one because it involved cash generating units. There was a hassle in doing it. Mr Gélard objected that they allowed people to subsume other intangibles into goodwill. The chairman took a vote on the staff recommendation which fell 4-8.

Ms Fisher reported that respondents had suggested that the process of allocating cost in a business combination to separately identifiable intangibles should be simplified. The staff thought that businesses would review intangibles as part of the decision to make a business combination but were suggesting an undue cost or effort exemption. John Smith said it sounded to him like creating an option. Mr Garnett said this was a consequence of other decisions they had made. They could not give a by on this one.

Paul Pacter observed that he took it 18.2 was rejected. He asked if they also rejected 18.3. Jim Leisenring remarked that he thought they did people a favour by making them look at contingent liabilities. They blew by them and ignored them then later they had to live with the consequences. Warren McGregor observed that he had not known that Mr Leisenring was so benevolent. Mr Leisenring replied that he was just a nice person. David Tweedie commented that that was the second mis-statement from Mr Leisenring in this session.

Ms Fisher said that issue 18.4 concerned adjustments to fair value after acquisitions. Comment letters had said the ED was unclear on this. The staff proposal was to add guidance from IFRS 3. (The Board agreed). Issue 18.5 was a suggestion that use of

book values or pooling of interests should be allowed for business combinations. The acquisition method was not appropriate for entities such as cooperatives. The staff recommendation was not to allow this. (The Board agreed)

Ms Fisher said the next section concerned leases. Issue 19.1 was a request that lessees should not be required to use the straight line method for operating leases. The staff recommendation was not to change the basic approach but to add another exception for where the lease payments rose to compensate for higher costs on the lessor's behalf.

Warren McGregor disagreed with the suggestion. He thought this would provide scope for quite a lot of misbehaviour. Paul Pacter explained that they had worked on this before the IFRIC position reinforcing the time basis in IAS 17. He did not think the potential consequences were that dramatic. All they were saying was that if it was clear there was an inflation provision in the lease, straight line could be ignored. Ms Barth thought this was not operational. How was the lessee supposed to know why the lessor had written the lease like that? Anything the lessee asserted could not be refuted.

Bob Garnett remarked that IAS 17 was clear on this: time mattered. If a lease had a 5% increase built in, the accounting was dramatically different from a lease with a flat rental and a retail price index adjustment. The people asking for relief were not big corporations. IFRIC could only interpret the standard and that talked about time, not about economic benefits. John Smith thought the lesser was always going to recover their costs. He doubted that this could be made operational. Mr Pacter asked if the Board would allow the staff to bring back different wording that dealt only with inflation. (They would)

Michelle Fisher introduced issue 19.2 which was a suggestion that finance leases should not only be measured at fair value, but also at the present value of the lease payments. She suggested they defer this issue since the staff had been asked (issue G13 in the May agenda paper) to review the use of the term 'fair value' in the ED and replace this with more descriptive terms. (Board agreed)

She went on to issue 19.3 which was the suggestion of simplifying the criteria for determining whether a lease was finance or operating. The staff recommendation was in two parts. 19.3(a) was that all leases should not be classified as operating (Board agreed) and 19.3(b) was that staff believed the relevant paragraphs were clear but accepted that there was confusion about what was a 'major part' of an asset's life and would change this to 'substantially all the economic life of the asset'.

Mr McGregor did not agree. In practice this was interpreted as 75% in line with the US standard. Mr Pacter noted that people asked what major part meant. They said it could mean 40%. They did not know the US literature. Ms Barth observed that 'major part' came from IAS 17 – people must be interpreting that. They should not introduce differences with IAS 17. Mr McGregor said they should explain 'major part'. Mr Gélard said they should not arrive at a position where there were fewer leases on the balance sheet.

David Tweedie asked who would move to substantially all: only 2 people. Mr Pacter said they would leave major part but come up with some guidance.

Issue 19.4 was a question from field testing, Ms Fisher explained. People wanted to be able to capitalise leasehold land. IAS 17 had an exception for investment property. The staff was not recommending any change. Mr McGregor said he hoped that they would see there was good reason to change IAS 17. David Tweedie replied that he thought that was being done in annual improvements. Mr McGregor said the staff had pulled it out for further consideration.

## AGENDA PROPOSALS

### Liabilities and equity

Liz Figgie introduced Paper 2A. She noted that liabilities and equity was currently on the research agenda of the IASB. The staff recommendation was that it should be moved to the current agenda. This had been proposed to the Standards Advisory Council (SAC) in June and they were in favour. Did the Board agree?

Mr Yamada indicated he wanted to speak. David Tweedie suggested that Mr Yamada did not really want to debate this. Mr Yamada replied that he did not disagree with the proposal (cheers) however, he thought that if they did not agree with the FASB approach, they risked ending back in IAS 32. Ms Figgie said the proposal did not pre-judge any decisions. John Smith asked when they were going to narrow the choices and was told October.

Bob Garnett said he had concerns with moving ahead right now when they had not finished this section of the conceptual framework. He was a basic ownership enthusiast but he doubted that by 2011 they would have convinced enough people and they would end up with a mish-mash. They should get the conceptual framework sorted out to prepare the ground. Mr Smith said he did not think they would get a lot of support from the conceptual framework. He would just as soon move forward. Mr Yamada was concerned about the relationship between the two, and what would happen if they went to basic ownership.

Mary Barth asked if she was right that this project was only dealing with financial instruments and not non-financial liabilities. The framework had to ask a different question. Mr Zhang wondered how quickly they could advance this topic. He was also concerned about the relationship with the conceptual framework. Philippe Danjou said he supported the proposal. He thought it was unfortunate that the FASB had established a preliminary view and noted there was some possibility they might not achieve convergence – criterion three for a decision. Warren McGregor observed that people seemed to have misconceptions about the scope of the project. They should change the title. He did not think the conceptual framework implications were something to be concerned about.

David Tweedie asked if it should go on the agenda. The vote was 11- (Bob Garnett against)

## De-recognition

Christian Kusi-Yeboah introduced paper 2B. He said the proposal was that the de-recognition project should move from the research agenda to the current agenda. Did the Board agree? David Tweedie said Board members could explain themselves to the G8 finance ministers if they disagreed. Jim Leisenring asked if this was a joint project. Mr Kusi-Yeboah said it was on the agenda for the joint meeting in October.

## REVENUE RECOGNITION

Jeff Wilks moved on to the last section of the paper (para 30) on re-measurement of performance obligations. He said that re-measurement might be an option when a regularly observable exit price is available. He said this would most often affect a situation involving commodities contracts or financial instruments but staff had wondered whether a re-measurement approach was worth including in a general standard given the limited situations where it might occur.

(Henry Rees of the IASB staff continued at this point as the video link was breaking up). Mr Rees said that staff were working on the assumption that these commodities would not be in the scope of the general standard and so staff did not feel it was necessary to articulate a general approach in the draft. He directed the Board to questions 7 and 8 in the paper and asked if they could think of any other situations where re-measurement might arise.

Jim Leisenring said he agreed with staff on commodities contracts and understood the financial instruments issue but his concern was inherent to the approach in the paper. He felt it was counterintuitive to adopt an approach where your fortunes could sink dramatically in a period and yet you would not have to re-measure. He felt that overall, the Board's definition of an onerous contract was not robust enough to cope with the approach. He said he was also concerned that the Board would not be able to reconcile its answers with FASB's as they would not be the same. Where revenue recognition interacted with inventory, this would be a particular problem, he said.

Warren McGregor felt Mr Leisenring had skipped onto the next section. Mr Rees said it was implicit in this section of the paper that the Board would have to discuss the triggers for where a performance obligation became onerous. That was something that would have to be brought back to the Board, he said, and asked the Board to concentrate on questions 7 and 8.

Philippe Danjou said that travel and insurance brokers would have an exit price observable in an active market. This caused some discussion among Board members, with Stephen Cooper and Jim Leisenring disagreeing that these would meet staff's definition. Jan Engström said he agreed with staff that there would be very few examples in practice. Mary Barth said she could not see why it was relevant that there were only a few. If there was just one example, why not re-measure? If the price was available, it she could not see any reason not to use it. Wei Guo Zhang said the Board was not denying that a price might be available, but he would be reluctant to use it because it might not be reliable.

Warren McGregor agreed with Mary Barth. These types of performance obligations were not sitting in isolation in IASB literature, he said. He could see no reason not to re-measure. Jan Engström said he could not see the point of re-measurement – if he bought an airline ticket there would be no value in him tracking the price fluctuations before he flew. Bob Garnett said it seemed that the Board had been able to identify situations where there would be an observable exit price, and so staff had got it wrong in the paper. But if the Board wanted to adjust after initial recognition, you had to go back to the question why not adjust on recognition? He agreed with Mr Engström on this, he said.

Jim Leisenring said that even so Mary Barth had raised a question that would need to be answered. The solution was to say in the draft that even though an observable price may be available, the model was that you do not re-measure.

Warren McGregor said it would be helpful to know whether insurance contracts were scoped out of this project. Henry Rees said he understood that that might be an obligation you would want to re-measure but staff felt insurance would be outside the scope of the revenue recognition standard – although clearly the staff from both projects would need to discuss this issue. Tatsumi Yamada said it was right that insurance contracts were scoped out. He felt that as long as the customer consideration approach was used it did not matter if there was an observable market price or not. His problem with the paper, he added, was with the next section, which he felt was inconsistent with IAS 37.

Stephen Cooper said he agreed with the staff on questions 7 and 8 – going onto ebay to find an observable market price was no basis for revenue recognition. But he was concerned about just scoping out insurance contracts. Insurance was a revenue recognition issue and the accounting of both issues needed to fit together.

David Tweedie asked if any Board members disagreed with staff's conclusion on questions 7 and 8. Jim Leisenring, Warren McGregor and Mary Barth said they disagreed.

Jeff Wilks continued with the next issue (para 37). He said there was another set of circumstances where some Board members felt you might want to re-measure, namely multiple reporting periods where the obligations required to settle are uncertain. Staff were recommending that the re-measurement approach should not be used for these uncertain long term obligations. He said the Boards already had various ongoing projects or existing standards for many of them and overall all staff felt that these, along with the onerous contracts test, would supply enough information for users. He directed the Board to questions 10, 11 and 12 in the paper and asked if they felt that the onerous contracts test would cover most situations.

Bob Garnett said that so far the Board had been considering an entity's contract with a single customer but there were other situations where the contract may be with groups of customers. The question of loyalty programmes and IFRIC 13 was coming to mind, he said. At the moment people were looking at the portfolio of obligations and use their experience to true up an estimate. He asked if staff had considered cases where the view of a portfolio as a whole might affect the overall outcome. Jeff Wilks said staff had considered that, mainly in relation to warranties. Staff were saying that if

insurance was scoped out of the project a re-measurement approach would not add much to the process.

Warren McGregor wondered what would be left if insurance, leases and financial instruments were scoped out. He said he was also concerned by the comment in the paper that significant negative surprises were a primary concern – he felt that if you did not re-measure in these situations you were not providing a faithful representation of the economic burden faced by the entity. He added that the Board liked to lecture constituents on the benefits of consistent accounting but it was creating an inconsistency here. Jeff Wilks said the paper asked the Board if it could think of any other examples where re-measurement might be needed – if the answer was no, staff felt re-measurement was not worth doing.

Stephen Cooper asked if that meant that long term contracts would be scoped out. Henry Rees said they would not. Entities would use the locked in approach and re-measure if the contract became onerous. The question was, though, whether doing that provided useful information. Mr Cooper said he agreed with locking in and not re-measuring in the case of selling sweaters and so on, but he did feel that there were situations where re-measurement was appropriate and insurance was one of them. If the Board could develop a model that was applicable to insurance and other circumstances that would be a step in the right direction. He felt it was too early to close off that discussion.

David Tweedie said it was difficult to make a decision until the board knew what the onerous contract test would be. Gilbert Gélard asked what would be different about the accounting from current practice with a long term performance obligation model. Henry Rees said that in the case of a construction contract to build a house, a transaction price would be allocated to each stage (clearing the site, building the structure etc) and at the end of each stage it would be considered that resources had transferred to the customer. The allocation became revenue at the point of transfer, with no re-measurement unless the contract became onerous.

Jim Leisenring said he would minimally re-measure the things he had measured at fair value on day one, irrespective of whether the contract was onerous or not. David Tweedie said the board seemed to be coming to the view that it had to discuss onerous contracts first. Mary Barth agreed. She was anxious to see what the onerous contract test would be. She added that she failed to see why the board would require entities to recognise liabilities that were greater than their obligations. Why only re-measure in one direction? Doing so was inconsistent with the Conceptual Framework's requirement that a number be free from bias, she said.

Wayne Upton said it would be helpful if staff knew beforehand what Board members didn't like about the current onerous contract test in IAS 37. Peter Clark said staff would bring back a paper on onerous contracts in September and as a result the timetable for this project was slipping a bit, since a pre-ballot draft was due in September. He added that the Board did not need to find answers to every question for the discussion paper and needed to be realistic about what it could achieve.

David Tweedie thanked Jeff Wilks of the FASB staff, who had come to the end of his fellowship, for his work.

## IFRIC UPDATE

Tricia O'Malley said IFRIC had discussed the comment letters for D 23 on distributions of non cash assets to owners and D24, customer contributions. The Committee had been asked whether it felt there was enough support to continue to an Interpretation and it had agreed that there was.

On non cash distributions to owners, IFRIC's conclusions were to reaffirm the draft recommendations on recognising dividend liabilities at fair value and recognising the gain or liability on settlement in the p&l account. The Committee had concerns about the time between when a liability is recognised and settled and had asked staff to develop a paper analysing the alternatives.

On customer contributions, she continued, IFRIC had agreed that if an asset belongs to an entity receiving the contribution, the asset should be reported at fair value. The Committee also needed to deal with the timing of revenue recognition, she said. Warren McGregor asked if IFRIC was having trouble identifying the performance obligation. Ms O'Malley said that was the most difficult part of the project and IFRIC had agreed to go ahead with its discussions while recognising that it might not be able to provide useful information in that area.

She added that overall some very good analysis had come out of the project. On the question of the obligation to maintain continuing access, IFRIC had come to the conclusion that it arose as a result of the operating licence and not as a result of the customer contribution. Jim Leisenring said the entity would not be in a position to deliver at all without the contributed asset. Warren McGregor said some people might find an answer difficult to accept if it resulted in immediate revenue recognition. Tricia O'Malley said a more difficult issue might be to identify whether there was a bundle of services or just one.

Ms O'Malley continued that IFRIC was also working on the re-deliberations of IFRS 2 and IFRIC 11, on group share-based payment transactions. Based on analysis of the comment letters received, it had concluded that the draft did not achieve the objective of making sure everything was in the scope that should be in. IFRIC had agreed with staff that it needed to change definitions and scope to avoid a further succession of queries. This had to be done by the Board and the beginnings of that work would probably be seen by the Board in September.

Jim Leisenring said he had read this section with some alarm because it was important to be clear whose financial statements you were talking about. He was worried about the difference between the receiving and settling entity. Tricia O'Malley said the project was intended to deal with all potential players in the transaction and addressed their individual financial statements, it did not affect the consolidated position. The problem was that new structures kept cropping up. IFRIC just wanted to be clear about what was in the scope before it started talking about what to do with the debits and credits.

She said IFRIC had considered the comment letter analysis but was essentially done with this project as it required amendments to standards. So that was heading back to the Board.

She continued that IFRIC had tentatively agreed to add an item on the costs associated with environmental legislation and was looking at whether the original issue raised with it could be widened to consider all legislation that involved compliance costs.

Finally, IFRIC had recommended that the Board consider guidance to clarify the application guidance of IAS 39, concerning the application of the effective interest rate method to a financial instrument whose cash flows are linked to changes in an inflation index.

#### EXPERT ADVISORY PANEL

Hilary Eastman gave an update of the work of the expert advisory panel on valuing financial instruments in markets that have become inactive. She said the Panel had recently held their third meeting and the aim of the discussions was to help the IASB in reviewing best practice in valuation techniques for financial instruments. She said the Panel had met on 13 June in London and had identified specific measurements and disclosures used in practice. A sub group had met again in July to discuss these in more detail. The Panel had discussed the measurement of financial instruments where no market prices were available and new models that had been developed as a result of the credit crunch. It had also discussed forced transactions, such as fire sales, and measurement of the changes in non performance risks.

Overall the consensus had been that IAS 39 was generally clear when it came to fair value, but some approaches that the board may need to consider had been raised. The next meeting was scheduled for 31 July, said Ms Eastman, when the aim was to discuss a paper summarising credit crunch issues and how practitioners have dealt with them. A draft paper would be published on the website for interested parties after the meeting.

She added that the panel's input would also feed into the fair value project, and it would then move on to discuss disclosures.

Jim Leisenring said that several complimentary comments had been made about the Panel's work at a recent SEC roundtable meeting. The tone from other discussions seemed to be that it was not true that market prices were not available for financial instruments – they were available, but people did not like them. He asked if the Panel felt the same way. Ms Eastman said that was outside the Panel's discussion area. John Smith said there had been discussions about forced transactions and how the price might be distressing but the fact was that you had sold at market price.

#### CONSOLIDATION

Alan Teixeira introduced the session. He began by providing an overview of the staff working draft of the planned ED (the draft is contained in agenda paper 14C) but Mr Teixeira began by giving an overview of the project from a set of slides that was only available to board members. The new paper summarised information from agenda

paper 14A and other papers, but it is not possible to match the discussion with relevant sections of that paper).

Mr Teixeira said the purpose of his introduction was to identify drafting differences between IAS 27/SIC 12 and the new staff draft, as well as identifying sections of the new draft where the drafting may not reflect Board decisions to date. He said staff were looking for the Board to identify areas of the draft where more guidance or analysis is necessary or where they had concerns. He said the draft was deliberately skeletal because staff felt it was easier to add material than to remove it, so he asked the Board to identify areas that were in need of expansion. The Board would go on to discuss disclosures later, he said.

Mr Teixeira said that the staff draft had been written on a number of assumptions. Many tentative decisions had been made over the several years this project had been under discussion and it was felt that it was time to draw a line under the discussions and make some assumptions. These were: that the principles implicit in IAS 27 and SIC 12 should form the basis of the draft; that tentative decisions made by the Board were valid; and that the general direction developed so far was appropriate. The standards were not fundamentally flawed, he said, but were not being applied consistently and there was clearly tension between the IAS 27 control model and the risk and reward emphasis in SIC 12. Staff's overall aim was to develop a cohesive control based model that encompassed structured financing and investment vehicles. Staff felt that if this was achieved the level of consolidation would be qualitatively the same as it would be if IAS 27 and SIC 12 were applied properly, although some reporting entities would end up consolidating more entities than before, because they had not applied the standards properly in the past. Staff felt the proposals would provide users with better information about the risks associated with relevant off balance sheet entities and the effect of legal structures on the reporting entity.

Mr Teixeira emphasised that the project was not just about SPEs. A number of other problems needed to be addressed, such as when options transfer control, and agency relationships. He said that between July and October staff would bring to the Board papers on the control definition, significant involvement and disclosures. At the same time it would test the concepts with a selection of preparers, auditors and users. At least one roundtable would also be held in September. He noted that the comment letters on Phase D of the Conceptual Framework project were due in September and he hoped to co-ordinate with that project on control. The aim was to publish an ED in Q4 of this year.

Philippe Danjou commented on a list of 'problems that need fixing' in Mr Teixeira's presentation, which included veto rights and agency relationships. He said it was a long time since IAS 27 had been reviewed and it was important not to miss anything. He wanted to be sure that something else wouldn't come back to worry the board at a later stage.

Mr Teixeira asked the board to look at the staff draft in agenda paper 14C. He said this was an unusual approach for the Board and emphasised again that the draft was deliberately skeletal.

He asked the board to consider the core principles in paras 1 to 3 of the draft, which he hoped were relatively innocuous. Philippe Danjou said that para 1 had the notion of combining assets, which was not in IAS 27. Tatsumi Yamada said the notion of control should be a core principle but was not mentioned. He added that it was odd that para 3 was much more detailed than paras 1 and 2 – readers tended to return to the principles if they could not find the answer they were looking for in the draft, so they should be clear. He felt these were too general.

Jim Leisenring did not think that the principles said what staff meant them to say, and that they went further than the decisions the Board had made to date. He was also concerned that ‘reporting entity’ had been used when the board was not clear on what that meant. David Tweedie said it was clear that ‘reporting entity’ was going to cause problems and asked the board to continue the discussion outside the meeting. He did not want to get bogged down in drafting issues. Mr Teixeira said the question of the reporting entity and the legal entity were not drafting issues. Staff felt that the reporting entity could be bigger or smaller than the legal entity. The legal entity was designed to capture trusts and partnerships, he added. If the concepts were not right staff would have to think of something else. Mary Barth said the problem was that the legal entity had been defined in terms of how it did its accounting. The Board had gone to great pains in the past to get away from the legal entity when it talked about the reporting entity.

David Tweedie asked if the Board agreed broadly with the principles. Warren McGregor said he wanted to be sure the link with IFRS 3 was clear. Bob Garnett said there was no need for para 3C to talk about significant involvement as there was already a standard for that.

David Tweedie suggested the Board could take the opportunity in the draft to ask people whether they felt associated companies were still needed. He felt there were historical reasons for the existence of associates that no longer applied. Warren McGregor said that was an appealing idea. Mr Teixeira said staff had seen significant involvement as a broader notion than significant influence. The problem was that if the net was cast too wide too many things were captured. Tatsumi Yamada asked if the Board wanted to keep significant influence in the future, as it was very confusing. David Tweedie said that if it kept significant involvement it would have problems with significant influence. He felt the Board should just ask the question about getting rid of associates, The Board agreed.

Mr Teixeira moved on to paras 16 to 19 of the draft, which discussed restrictions on the power of a legal entity. He said staff had tried not to think in terms of predetermined policies but in terms of power. In some cases so many powers were taken away from an entity that there was no need for a corporate governance structure such as a board. All that mattered were the powers that the entity had left. There were clearly grey areas to this approach but he felt it was a more helpful way of thinking about it.

Jim Leisenring said it was more helpful but was not without its difficulties. Mary Barth agreed it was a better way of thinking about the issue but she had been confused about what staff felt was the most important thing the entity could do. Warren McGregor felt staff were heading in the right direction

Bob Garnett said the draft felt disjointed because the aim was to put together IAS 27 and SIC 12 but there was a separate discussion of items. Mr Teixeira said that was a good point and staff had shuffled things around because they didn't want a discussion of SPEs to drive the standard.

Mr Teixeira moved on to para 20 and control of a legal entity. He said the definition of control had evolved over a couple of years and he felt that the last words of the definition, 'as if they are its own' were still causing a lot of angst. Jim Leisenring said the Board needed to be careful because at the moment anyone involved in securitisation could read the definition and think they were home free. Gilbert Gélard said that even if you owned an asset in your own right there could still be restrictions attached. Warren McGregor said if the phrase was causing problems it should be changed or deleted. This wasn't a new problem. Mr Teixeira said if the phrase was deleted you could get to a situation where if you were a dominant party you could manage the assets without owning them. He added that he didn't get the impression that the Board disagreed conceptually with the definition so maybe it was a drafting issue.

He moved on to para 26 of the draft and the relationship between benefits and power. Current IAS 27 tended to concentrate on power first and benefits second, he said. Staff had switched the two around but the aim was to use the two together. He directed the Board to the definition of benefits in para 27 and stressed that they had to be variable and were broader than just the returns of the legal entity (an example of this could be synergies). He said the point was that you had to have the power to be able to generate decisions. But it was not possible to just focus on the entity because some benefits may be outside of the entity. He said that he suspected that in many cases you would have to look at the initiation of the transaction. John Smith said he agreed with that, but paras 31 to 32 of the draft did not seem to say that at all. Jim Leisenring said he had been concerned by those paras because he was used to benefits being positive or negative but this seemed much more convoluted. Mr Teixeira conceded that the drafting may have over-emphasised the problem staff were trying to address.

A number of Board members had problems with para 35 of the paper. Jim Leisenring said that overall, the draft was too subtle. It needed to have the subtlety of a train wreck, he said. Mr Teixeira said staff would try to be more blunt in the redraft.

He continued that the rest of the core sections were drawn largely from IAS 27 and had not changed in form. He asked the Board to move on to the application guidance in Appendix B. Paras B4 to B12 of the paper mostly came from discussions the Board had two to three years ago, and he said staff were attempting to describe the factors that could combine to give you control. Jim Leisenring wanted staff to be much more explicit, and say that if you have, say 35% of the stock and that is more than 50% of the voting rights in the last election, you have control. You could be unconsolidated at the next election – that was the point of present control. Alan Teixeira felt that para B7a said something similar. Warren McGregor agreed with Mr Leisenring – why not just list the things that needed to be clarified in IAS 27? Mr Leisenring said it was not the ability to vote that mattered, it was the result. Stephen Cooper felt there was a

danger you could say you control something just based on who turned up at the last agm.

Philippe Danjou felt the draft focussed too much on how you get control and not enough on the notion of losing control. Mr Teixeira said he would consider whether a section on losing control was needed.

He moved on to para B16 and the section on significant involvement. He felt more analysis was needed on this because it was difficult to put the notion into words. The problem was that the notion centred around your ability to participate in the governing body, but a lot of new entities did not have a governing body. Stephen Cooper said he would have said that you should look through to the underlying assets, as you do with associates. Jim Leisenring had problems with the illustration in B14 as he felt people would rely on the example to decide what was important. Mr Teixeira said he would look at the section again, adding that he did not think staff had narrowed the grey area between control and non-control enough.

He asked for the Board's initial reaction to the expected returns section (para B20). He said this section also needed more work. Jim Leisenring said he could not see what expected returns had to do with anything. Mr Teixeira said it was important to know with financial instruments in particular whether your rights are participatory rights.

Mr Teixeira said he was not planning to go through the cases in agenda papers 14B, but they attempted to explain what the application guidance would mean. He said staff would redraft the draft ED in a less subtle way and he welcomed any comments offline. Jim Leisenring said that FASB staff should look at the cases – Mr Teixeira said they had already been sent the papers.

Thursday 24 July 2008

## IFRS FOR PRIVATE ENTITIES

Michelle Fisher continued going through Paper 8A discussing points arising from the exposure draft. Issue 20.1 concerned the measurement of provisions. She said that a small number of respondents had suggested simplifying the measurement. The staff view was that this should not be done, but they could add a few examples to help. (The Board agreed).

She said that issue 21.1 concerned the classification of liabilities and equity. The staff had sent a short questionnaire to cooperatives and other organisations to ask whether the recent amendments to IAS 32 dealt with their needs. They were still analysing the responses and would defer this issue to a future meeting.

Jim Leisenring asked if they were sure that all these cooperatives would qualify to use the standard. Mr Pacter replied that they were sure that many would not, but some would.

Ms Fisher moved to issue 21.2 on separation of compound instruments. Some had commented that this was difficult and should not be required. The staff felt that

splitting compound instruments was complex and unlikely to be feasible for small entities. Split accounting should not be permitted. Instead an instrument should be considered to be a liability unless the entity has an unconditional right to avoid delivering cash or another asset, in which case it should be equity.

Mr Leisenring commented that he did not understand the basis of the staff recommendation. He knew it was hard, but if they did not want to do hard accounting, they should not issue these instruments. Steve Cooper remarked that he did not think it was that hard. You measured the liability. You did not have to know Black Scholes.

(At this point John Smith came in. David Tweedie asked why he was late. He replied that there had been a line at the coffee machine.)

Paul Pacter said that this method had been used in the US in the past. Mr Leisenring added that he had never seen a small entity issue such an instrument anyway. Philippe Danjou also thought small entities did not do this. He said he had no sympathy with the proposal. Mary Barth thought this was not so hard. She also did not agree the proposal. Bob Garnett suggested they should leave the issue and see what evidence there was of a problem when it came to the post-adoption review.

David Tweedie said that was OK and asked if there was a paragraph explaining how to do it. Mr Pacter said they would put one in.

Ms Fisher moved to the next section, on revenue. Issue 22.1 concerned the percentage of completion method. Comment letters suggested that entities where the previous GAAP was completed contract might have difficulties with this. The staff were not recommending any change, but were proposing to add some examples. (The Board agreed). Jim Leisenring observed that he would not vote for it if they were not providing for deferred tax.

Ms Fisher said that comments were equally divided on government grants, with half supporting the approach of the ED and the rest supporting the option of using IAS 20. The staff recommendation was to remove the option to use IAS 20. Although the Board wanted to retain options the staff felt that the ED approach was a genuine simplification and offered better information.

Mr Leisenring said he did not see why this was special. What was different from all the other options they had retained the day before? Mr McGregor responded that IAS 20 was a horrible standard. He thought the ED was an improvement. The principle is 'sometimes', Mr Leisenring observed. Ms Barth said she agreed with Mr McGregor. They were not going to do things they knew were bad. They knew, the whole world knew, that IAS 20 needed fixing.

The staff recommendation was passed 10-2 (Jim Leisenring and Bob Garnett against).

The next issue was 24.1 on borrowing costs, Ms Fisher noted. 75% of comment letters had supported keeping both the expense model and the capitalisation model. The staff thought retaining the cost model was justified because the capitalisation was not clearly giving benefits greater than the costs of doing it. The staff recommendation was no change to the ED.

Jim Leisenring remarked that he did not know how issue 24.1 related to issue 24.2. In 24.2 they were saying nobody used capitalisation and it was not hard. Ms Barth observed that they had originally had a choice. They had removed the choice, the standard had been finalised. She did not see why they were going backwards for SMEs. Mr Yamada said he had the same view. Mr Danjou commented that he supported the staff, he had dissented from the change to the standard. He did not think the benefits outweighed the costs.

David Tweedie called for a vote on the staff recommendation which passed 7-5.

Ms Fisher explained that in issue 24.2 the reason they had recommended no simplification to the capitalisation model was on the basis that the expense alternative was available as relief. (Board agreed staff recommendation)

The next issue (25.1) was share-based payment. Many comment letters thought that equity-settled accounting should be simplified. The measurement involved knowing the fair value of the underlying equity at grant date and at each reporting date. They were still talking to people about this and the staff would defer putting the staff recommendation in 25.1(a) for the time being. However, they did have a recommendation at 25.1(b) on the allocation of settlement.

Bob Garnett observed that one of the problems that private entities had was that they did not know the fair value of their shares. One possible approach was to do a simplified valuation at grant date and then true up at exercise. On 25.1(b) he was opposed to the staff recommendation. IFRIC was going through excruciating exercises on precisely this point. They had a draft out for comment. IFRS 2 as amended would eventually be applicable here, and that was not based on an allocation of the group number.

Mr Leisenring said he was cynical as to what 25.1(a) was going to be. As they had put stewardship into the document, he did not think they could issue compensation without it passing through the income statement. Mr Pacter said they had not put stewardship in differently from full IFRS. Steve Cooper said he objected to the use of a sector index of volatility. They should always use the average volatility of the sector. The index would give a lower volatility. Mr Pacter suggested they defer both recommendations.

Ms Fisher introduced issue 26.1, impairment of non-financial assets. Some comment letters suggested that impairment should be done using value in use rather than the fair value less costs to sell method in the ED. The staff were suggesting that they should re-introduce the recoverable amount (the present value of the expected future cash flows from sale or use) and this should provide a ceiling value. The staff accepted that fair value might be difficult to find, and would allow entities only to use recoverable amount.

Mr McGregor suggested they would have to be more specific about how to calculate this. David Tweedie asked what they were doing about discontinued operations. Mr Pacter said there was no held for sale category. The chairman asked if they could say if the entity were going to sell the asset it should be in the balance sheet at the price

they expected to get for it (but no higher than the carrying amount) if not the present value. Mr McGregor clarified that the staff proposal was that if the entity was selling the asset, it was at cost or selling price, if they intended to keep it, it was value in use. Gilbert G elard said he was not happy about introducing management intent into it.

Mr Yamada asked why they had different accounting than IAS 36. Ms Barth said that when they had discussed it, they had said it was too complicated, so they had picked one method. Now some people did not like the simplified approach. She did not believe that estimating fair value was any more difficult than value in use. Mr Garnett suggested it was a problem because people thought of scrap value. He had never thought it was onerous to do two calculations. Mr McGregor thought they could leave the ED and explain it was not the wholesale price. Ms Barth added they could avoid using the term fair value.

Michelle Fisher observed that people had said it gave massive write-downs. Ms Barth noted that the issue was *why* – they believed it was because constituents misunderstood fair value. They thought it was a fire sale. Mr Garnett pointed out that if the introduced new terms it made it difficult for people to switch. Mr Leisenring commented that the problem was you bought a dump truck for \$50,000. The moment you drove it away it was worth \$45,000. That was the problem. Ms Barth said there were three possibilities. They could stick to fair value, they could re-define value in use, or they could revert to IAS 36.

David Tweedie took a vote. There was no support for the staff recommendation, but 9 votes in favour of a return to IAS 36. He added that the standard should make it clear that you only had to hit the target once: if the recoverable amount was higher than carrying value you need not calculate fair value. Mr Pacter said that was in IAS 36.19/20.

Ms Fisher moved to issue 26.2 on the requirements for assessing impairment of goodwill. Comment letters had asked for some simplification of goodwill impairment. The staff did not believe that the ED's requirements were difficult to understand. Their recommendation was in three parts. 26.2(a) was that they should add a presumption that goodwill related to the acquired business as a whole unless it had been re-structured or absorbed into the group. This would simplify step 1(a) on the allocation of goodwill.

Ms Barth observed that she did not know that the presumption made a difference. David Tweedie commented that this was just saying 'go no further'. Was that OK? (It seemed it was). He went on to note that 26.2(b) would have to change.

Bob Garnett commented that this was one of the most emotive problems. No solution had been offered at all by the working group other than amortising goodwill. This was a trigger for the impairment of goodwill once they start digging down and allocating goodwill. Ms Fisher observed that 26.2(b) had to be made consistent with the decision on 26.1 to revert to IAS 36.

Jim Leisenring said he did not see any cut they could make. They could say that if you did not integrate the acquired business, you looked at that. If you did integrate it, you measured the group as a whole. David Tweedie asked what people thought of Jim's

proposal. Mr Leisenring objected to the description. He went on that it amended IFRS 3 because you did not have to allocate to units. He was going to vote against it.

Jan Engström asked if he had got it right. You made a lousy acquisition with high goodwill and that got preserved for ever? That sounded like a good argument for amortising goodwill. David Tweedie suggested that if the entity had the systems to make the allocation, they should do it. But if they did not manage the business as separate components they should value the whole business. Ms Barth interjected that they had talked on their awayday about how they sometimes did standard-setting on the fly. They lost track of what they were talking about. She thought this was what they were now doing.

Paul Pacter said he would like to do 26.2(c): if the entity was unable to measure the recoverable amount of a component, they should write off all the goodwill. Ms Barth observed that it was a free choice. Mr Engström suggested they could explain in the Basis for Conclusions that they had made this so complicated because they knew users ignored goodwill.

David Tweedie suggested that the staff took Mr Leisenring's suggestion and put some rigour round it by saying that if you did not manage that way you took the whole group. Ms Barth agreed they could see what it looked like.

Tatsumi Yamada asked what was the difference between impracticable and undue cost or effort? Mr Pacter replied that the Board had decided in May that there should be no generic undue cost or effort exception but the staff had selectively proposed some specific ones, which the Board had mostly rejected. Impracticable meant you just could not do it. Undue cost or effort meant that you could do it, but the cost did not justify it. Mr Yamada commented that undue cost or effort seemed to allow anything – you could not prove the cost. Ms Barth noted that that was the problem.

Michelle Fisher remarked that she was not sure if issue 26.3 was still a problem. People had asked that the term cash generating unit be brought back instead of component. Mr Gélard thought it should be brought back. Mr Leisenring commented that it was not good have two names for the same concept.

Ms Fisher moved to section 28 on employee benefits. She reported that some comment letters had asked that SMEs should have all the options in IAS 19 for accounting for gains and loss on actuarial estimates. Ms McGregor observed that was terrible accounting. Ms Barth added the Board was in the middle of a project but its thinking was quite clear. Mr McGregor commented that this was the best part of the SME standard. Tatsumi Yamada, however, considered that their thinking was not clear yet – they had only issued a discussion paper. Ms Barth said her thinking was clear. Mr Cooper thought SMEs should have the Other Comprehensive Income option – it was available to other companies. Mr Smith suggested that if they could not pick this off here, they would never get rid of it. It would be putting them in a bind for later on. Mr McGregor pointed out they did not have expected return in the SME standard: were they going to go back? Mr Cooper responded that it was matching what was in the big book.

The chairman took a vote. Retaining the ED approach won 8-4

Ms Fisher continued: issue 27.2 was that some people wanted to be able to defer past service costs. The staff recommendation matched that for 27.1: they should stay with the ED arrangements. (The Board agreed).

Issue 27.3 was that people had suggested that the pension liability should be measured at the current liquidation amount. They did not want to get actuarial valuations. Mr Leisenring commented he did not understand that at all. Ms Barth said he should not bother to try. Paul Pacter said there were jurisdictions out there that required this currently. An alternative was fair value. Mr Yamada said it was required for tax purposes in Japan.

The Board had a discussion about what the current liquidation amount was and members offered examples if such approaches in different constituencies. Ms Barth finally said she could not support this. Every country had different schemes. A global standard-setter could not get involved in that. Mr Pacter asked if the staff should come back with a clear alternative proposal? David Tweedie thought they should do that. He reminded them about Sri Lanka where there were only three actuaries. The problem with this was they were going to see completely different measurements. Had the staff looked at the Sri Lanka method. Mr Pacter said it did get a liability on the balance sheet. Mr McGregor pointed out that they had learned that in Indonesia all companies had defined benefit schemes. He said he would be happy for the staff to look at this, although he had no great confidence in finding a solution. Mr Yamada also suggested they should not spend too much time researching this – he was sceptical about the possibilities.

Mr Pacter said it appeared they were not going to get to deferred tax. Mr Garnett suggested they just vote on it.

## MANAGEMENT COMMENTARY

Amy Schmidt told the Board that the staff's aim was to be able to publish an exposure draft in the fourth quarter of 2008. As a first step she wished to re-examine the conclusions of the DP. It would be inconsistent to draw up this document independently of the conceptual framework. The framework acted as a lead blocker for the project (when this was queried she said she had used the term umbrella in the paper). She had three fundamental questions for the Board: (1) which framework should she use: the old one or the in-process project; (2) did the Board think this applied to the management commentary? She thought it could be seen as a Basis for Conclusions for the financial statements. It was the why, when the statements were the what and how; (3) how tightly did they want to tie the document to the Framework – this was really a series of questions.

David Tweedie commented that the answer to the 'which framework' question was the in-process one.

Philippe Danjou said he had a query about helping the investors understand the strategies of the business. How widely was that meant? Did it include commercial marketing strategy? He thought it was more their financial strategy. They could discuss the scope of the management commentary. David Tweedie suggested this was

covered in paras 11/12 which talked about providing context to the financial statements. Mr Danjou thought context was an undefined notion. Bob Garnett pointed out that most assets in the oil and gas industry were off the balance sheet. There was important information about reserves and discoveries. It was difficult to be precise and restrict it to the financial statements. Mr Zhang said he agreed with Mr Danjou, they had to draw a line between financial and non-financial.

David Tweedie asked if people agreed with question 2 that the framework for the management commentary should be subsidiary to the Conceptual Framework. They did. Did they agree (question 3) that the objective should be the same?

Jim Leisenring said he understood question 3, but what about question 4, why was purpose different from objective? Amy Schmidt explained that while she accepted that some people used the terms interchangeably, she was using them to distinguish the different approaches used by the two documents to provide information for investors. Mr Leisenring responded that if she was saying the management commentary would not include an income statement and balance sheet, he could understand that. Ms Schmidt said she was going to use IAS 1 as a template, but that would be a separate discussion. Mr Tatsumi said he still had trouble with purpose and objective. The words would be translated the same in Japanese. Ms Barth said the staff just needed agreement on how the Board saw things, they were not there to agree the words.

Steve Cooper objected that the document talked about assessing strategy. The CEO is not going to say the strategy is useless. It should be to assess the risks and the investor can take a view. Mr Danjou suggested it should be to understand rather than assess. The investor should understand management's views, understand the strategies and assess whether they are likely to be successful.

Ms Schmidt asked if they agreed that the primary users should be present and potential capital providers. (They seemed to). Ms Schmidt moved to questions 6 and 7 (6 was whether qualitative characteristics were the same, and 7 suggested 'supportability' was more appropriate than 'verifiability'). Ms Schmidt thought the information in the management commentary would be softer than in the financial statements and might not meet the verifiability quality. She added that she had received some feedback from Board members that substituting supportability for verifiability was not a good idea. She could go to the conceptual framework team and see how verifiability might apply.

Mr Engström did not think they should start by changing the framework. Mary Barth remarked that freedom from bias and completeness were also important qualities. They had to be interpreted in context. Mr Gélard preferred supportability. Mr Leisenring noted the staff had used the word 'balance' instead of neutrality. Ms Schmidt said she thought they meant the same thing. Mr Leisenring responded that he did not see why they had not used verifiability and explained it with supportability. It was not verifiable in the same way as a number, but it was verifiable. The process was much the same. David Tweedie added you just did not get the same level of assurance. He thought supportability was quite clever.

Peter Clark interjected that the question was whether they could have the same word in the conceptual framework and the management commentary. His feeling was that the conceptual framework word was too far along the spectrum. Could they come up with a single word? He was going to suggest they had a shot at fixing this up and then re-debated it. He added he had heard that they wanted to keep faithful representation.

Mr Danjou noted that the nature of the business, in para 38, should not ignore the segments. Mr Leisenring agreed that it made more sense to put management comments against the segments. He also thought, given the stewardship objective, that the commentary should deal with strategy on management compensation. Gilbert Gélard asked if they were going to do governance here. Mr Danjou objected that they could not do everything: social reporting, environmental etc.

Mr Leisenring suggested they should also discuss tax strategy. David Tweedie said it was to answer the sort of questions investors would put to management based on the financial statements. Steve Cooper said he agreed about segments and there should be explicit comment on financing obligations and liquidity. They should also talk about unrecognised intangibles. Taxes would be great too. Mr Zhang thought there was a dilemma about going too broad or being too detailed. Mr Danjou suggested they could expand para 38(e) on drivers of performance. If they were too specific they would get resistance. Mr Leisenring commented that if this was supposed to be best practice they did not want to put the bar too low. David Tweedie noted that this was an exposure draft: they could not build it up afterwards.

Steve Cooper referred to para 43 and the idea of a medium user. He thought they should be ambitious and say it was for all users and leave it to the company to structure it – it was not too difficult. It was just presentation. David Tweedie thought they had covered question 8.

Ms Schmidt said there was one more question: did she have permission to start drafting the ED. Jim Leisenring remarked that they would have to sort out what kind of document it was. Ms Schmidt said the directors and the editorial people were working on this.

## FINANCIAL STATEMENT PRESENTATION

Denise Gomez Soto led the discussion from London. Kim Petrone and Tom Jones participated by video link from the FASB. Mr Gomez Soto said agenda paper 16 discussed the preliminary views document on financial statement presentation and in particular what should be included on the Board's long term view on OCI. In June, she reminded the Board, it had agreed on including a paragraph that said that it had a long term preference for reporting OCI items in the same manner to other non-owner changes in assets and liabilities, but that this was outside the scope of the financial presentation project and so the Board might address OCI in future projects. Paras 3.34 and 1.24 of the pre ballot draft summarised these points (see paras 2 and 3 of the agenda paper). One Board member had raised concerns about para 3.34, in particular whether the long term preference of all Board members was to eliminate the recognition and presentation of OCI items, and whether the Boards had specific plans to change OCI accounting in the future. The objective of this session was to discuss these concerns, she said.

Staff had prepared three alternatives for modifying or replacing the relevant paragraphs (alternatives A, B and C), which are detailed in para 5 of the agenda paper. Alternative C uses the wording from the June meeting and was more subtle than the others, since it was not explicit about the Board's long term view. Staff were recommending alternative A, or C. The first question for the board was whether it wanted the preliminary views document to mention a long term goal. If the answer was no, said Ms Gomez Soto, para 3.34 would be deleted from the draft.

Warren McGregor said other issues that could be categorised as long term views had come up in the discussion and one of these was interim reporting, which was set for the third phase of the project. Was the Board going to give any indication of what it was planning to do with interim reporting? IAS 34 was a horrible document, he said. And should the board be specific that there was a third phase planned for the project? Jim Leisenring said he did not find interim reporting as troublesome as Mr McGregor because interims were company reports and therefore had to comply with the financial statement presentation standard. He thought that summary reports were a bigger problem, and one that someone would have to address although he doubted that it would be the current board members.

Mr Leisenring added that he strongly supported alternative A. He wanted to delete the reference to the long term view because the board could not commit future boards to anything.

David Tweedie said he had been the Board member that had raised the issue. The elimination of OCI was the most controversial area of the entire project, he said, and it was a shame that the board could not tackle it now. His preference was to eliminate OCI but his concern was that he wanted to be sure that a strong majority of the Board agreed with that before the document said so. If the draft went ahead as it was, he was worried that people would assume that the board was going to get rid of OCI and it would have a fight on its hands. He couldn't see the point of walking into a firestorm when the document was a very good one.

John Smith said he also wanted to get rid of OCI but the Board was going to have a real problem persuading people to move to one statement and it should reserve its energy for that fight, not this one. He would favour alternative C. Warren McGregor agreed. He didn't want people to be distracted from the main objective of the document, which was to improve financial statements. But he wanted to be clear that the Board believed that further action on OCI should take place in the future.

Mary Barth said she also wanted to get rid of OCI but felt there were two issues here. The first was whether that was a majority view, and the second was whether the board said so in the document if it was. The Board could not bind its successors to anything, though, and maybe it was gratuitous to raise this point at all, given the firestorm it could cause. She said she could live with alternative A or C but would prefer to say nothing. The question was whether it was helpful for constituents to know what the Board's long term view was. Jim Leisenring said that was not something that could be hidden, given that it had voted on the issue in public. John Smith said including the long term view would be like saying in the document that the board favoured fair value as well. Mary Barth said that not everything the Board decided had to be written

up in a document. Gilbert Gélard said that if a view was not relevant to that particular standard there was no need to say anything.

Tatsumi Yamada felt the Board should have a strategy for setting out its long term views – the Board had discussed elimination of OCI at length but he was not sure that it should be mentioned in the document. Steve Cooper did not agree with alternatives A or C and said he would not have voted in favour of the long term view if he had been a member of the Board at the time. In order to deal with OCI the Board had to deal with presentation more comprehensively than it had done so far.

Bob Garnett said he remembered the Board expressing a preference during the discussion and his was to eliminate OCI, but at some point it must also have decided not to carry through that decision. The Board was not eliminating OCI in this document so it should not mention the view, even though the excuse for not doing it was poor, in his view. Jan Engström agreed but felt the document should say that elimination of OCI had been discussed by the Board. He couldn't see the point of picking a fight on this issue and thought the Board should say briefly that it had been discussed and then put the issue aside.

Philippe Danjou said he would not mention the long term view either. The Board was transparent so it was well known that it had been discussed. Jim Leisenring said he agreed with Mr Garnett – the Board could have gone ahead with its plan in this document but it did not. But he did feel that the strength of Board preference was relevant. David Tweedie said the paper was a discussion paper so all views should be reflected. Gilbert Gélard said the Board needed to be wary of blanket statements like getting rid of OCI – that was something that should be considered standard by standard. Steve Cooper agreed. This was not the document to say the Board was getting rid of cash flow hedging, he said. Jim Leisenring said it was not a case of getting rid of cash flow hedging but of the presentation of it.

John Smith said the Board had backed off eliminating OCI because it would affect measurement and recognition, which was outside the scope of the standard. The Board had also said it would pick off OCI items one by one. Wei-Guo Zhang said he would rather stay silent or go with alternative B.

Tom Jones said that years ago the Board had wanted to move to one statement but had been met with much more resistance than it expected. He felt there was no need to take on the fight now, when the board was not even planning to do what people were afraid of.

David Tweedie asked the Board if it wanted to vote now on whether its long term view was to eliminate OCI. Philippe Danjou and John Smith said they did not want to vote until they knew how it would be achieved in each case. Kim Petrone said that at the last meeting the Board had voted by 8 to 5 in favour of including a mention of the long term view in the draft. FASB had agreed and she felt that they would now agree with alternatives A or C. David Tweedie said he felt the standard would be rejected in some parts of Asia if the long term view was included. John Smith said it was like there was a big, ugly guy in the room. The question was, do you tell him he's ugly?

Bob Garnett said he and Jim Leisenring would rather say that they wanted to eliminate OCI now and were disappointed that the board was not doing that. They also wanted the Board to vote now so they could see who would get rid of OCI.

David Tweedie asked for a vote on question 1 in the paper, which asked whether the Board wanted the preliminary views document to mention a long term goal. The Board voted by 10 to 2 against. He then suggested the board go back to Mr Garnett's point of whether their view could be included – he did not want to kill any ideas, he said. Mary Barth said adding a comment similar to Mr Garnett's would be a way of getting an alternative view into a preliminary views document. David Tweedie said he could not see anything wrong with including a paragraph saying that some Board members wanted to get rid of OCI while others wanted to set out criteria for doing so, but the Board had decided not to deal with the issue in this project. He concern had only been that he was not sure that the Board's preference was as clear as it said it was in the original draft. It was agreed that staff would draft a paragraph for the board to review before the end of the meeting.

## LEASES

Rachel Knubley led the discussion in London, with FASB staff participating by video link. Tom Jones also participated from FASB.

Ms Knubley reminded the Board that it had discussed the technical plan for this project in June, which envisaged publication of a discussion paper in November this year and a final standard in Q2 2011. The technical plan was based on a new approach to the project, which was to address lessee accounting only and defer the consideration of lessor accounting, and that the current IAS 17 finance lease model should be applied wherever possible to operating leases. The requirement for lessees to classify leases as operating or finance would be removed.

The purpose of this session was to seek the board's agreement for the proposed approach. Ms Knubley stressed that it was unlikely that the Board would meet its deadline if it did not agree. Staff felt that the approach would result in a significant improvement in the accounting for lessees. She added that FASB had discussed the papers the previous day and had supported the overall approach, although they had made suggestions on a number of points.

### Overview of approach for discussion paper

Simon Peerless of the IASB staff introduced agenda paper 13A, which discussed the overall approach. He said he was asking the Board to confirm the two key decisions underpinning the approach – that lessee accounting only would be considered and that the IAS 17 model would be applied to all leases. The main aim in starting the project, he noted, was to deal with problems that were arising mainly in lessee accounting, and which applied to a large number of entities. Staff felt these issues could be solved relatively quickly. The problems with lessor accounting were less widespread and could take longer to resolve, he said. He directed the Board to question 1 in the paper and asked if it agreed that the consideration of lessor accounting should be deferred.

Bob Garnett said he was disappointed that lessor accounting would not be addressed in the project. He felt that if the Board was able to consider lessee and lessor accounting simultaneously some of the measurement issues might have greater clarity. He would reluctantly agree with the staff recommendation, but only if the results improved financial reporting for lessees. Jan Engström said he was also disappointed. He added that he didn't want staff to say that lessor accounting had been 'dropped' from the scope – he wanted it included in the scope, perhaps as a second phase. Warren McGregor said he would also reluctantly agreed to go ahead on the basis the Board could improve the accounting for lessees. But he felt the Board had more confidence in its decisions when it considered both sides of the transaction at once.

Jim Leisenring was sceptical that the Board could improve the accounting for lessees. He was not comfortable with dealing with lessee accounting and not with contingent rents. Tatsumi Yamada supported the staff recommendation and asked how long it would be before the Board could consider lessor accounting. Ms Knublely said it was impossible to answer that as there was no project plan for it.

Philippe Danjou said this was a project on lease accounting, not lessee or lessor accounting, so lessors were not 'dropped'. He saw it as lessee accounting being the first phase. John Smith said he was concerned about removing the consideration of lessors entirely – if the Board came across something while considering lessee that made sense for lessors then it should consider it. He added that he felt staff could do both sides of the equation within the time frame if it really wanted to. Wayne Upton said the project team was not crying wolf about the timetable – it was not automatic that lessee and lessor accounting would mirror each other. Gilbert Gélard said it was impossible to ignore lessors completely since if a lessee sub-let he became a lessor.

David Tweedie called for a vote. The Board voted by 11 to 2 in favour of considering lessee accounting only (Jim Leisenring and John Smith voting against).

Mr Peerless said the second question for the Board was whether it agreed with the general approach of applying the IAS 17 model to all leases. John Smith said he would have liked to have seen a paper with more details on the residual value guarantee. Ms Knublely said that had not been discussed in this paper but she would say that you would look first at the IAS 17 treatment. Residual value guarantees would be mentioned in the discussion paper, she added, but there would probably not be a preliminary view expressed – that would be left to the ED stage. Warren McGregor said staff needed to bear in mind that the scope of IAS 17 was quite broad.

Tatsumi Yamada said that in some cases an operating lease may be short and cancellable. He asked what criteria staff had in mind when applying the IAS 17 model to an operating lease. Mr Peerless said staff were thinking in terms of the mechanics of the model rather than the conceptual underpinning of the model.

David Tweedie asked for a vote and the Board agreed unanimously in favour of the proposed approach.

### Options to extend or terminate a lease

Ms Knubley said agenda paper 13B addressed the question of how to account for leases that contained an option to extend or terminate. This had been discussed by the Boards in May 2007, when they had been unable to reach a consensus. Staff shared some of the Boards' concerns raised at that meeting, she said, and so were proposing an alternative approach. Rather than recognising the option as a separate asset, staff were recommending that recognition of the lessee's right of use asset and rental liability arising under the lease be based on an assessment of the lease term that takes into account the likelihood of the options being exercised. She said FASB had agreed not to recognise the option separately and to base recognition on an assessment of the lease term. David Tweedie asked if anyone disagreed (they did not).

Ms Knubley said the next question was what probability threshold should be used. IAS 17 required optional periods to be included when it was 'reasonably certain' that the option would be exercised and staff were recommending this approach. FASB, however, had disagreed, favouring a best estimate of whether the option would be exercised.

Warren McGregor asked what FASB meant by a best estimate. Ms Knubley said that if you had a lease for five years with an option to extend for three years, you would look at all contractual and non-contractual business factors to come up with your best estimate (and not probability) of what the lease term would be. Mr McGregor asked if that was consistent with the 'more likely than not' notion in IAS 37. Ms Knubley said FASB were reluctant to place a probability threshold on what they meant – they did not want a bright line. Bob Garnett said that in Ms Knubley's example, the lease term could be anything from 5 years to 8 years. If there were a range of outcomes you would not necessarily have a 'more likely than not'.

Mary Barth said she agreed with FASB. She was not keen on thresholds either and would go for a probability weighted approach. John Smith was not sure if the idea was operational. Once you go beyond the minimum term of the lease, the obligation looked less and less like a liability, in his view. He could look at optionality over the whole period if he followed that view, he said, and was concerned about structuring.

Steve Cooper said he would be happy with showing the lease term as 6.5 years. Mary Barth said that if there was a 50% probability that it would be 8 years and a 50% probability that it would be five, the answer was 6.5 years, which may not be possible but it was the answer. Jim Leisenring disagreed strongly with this view, saying he would rather go back to separately valuing the option.

Steve Cooper said the problem was that if you had a five year lease with an option to extend to eight and it was likely that you would extend, you would end up with the same measurement of the asset as you would for a non-cancellable lease of eight years. The disclosures would need to be very transparent about that. He added that he was surprised that no-one around the table had thought that the option was not a liability. You were recognising an obligation for eight years when you were not obligated to make eight payments.

Jim Leisenring said reasonable certainty was a high threshold but it made sense. But he felt that 6.5 years was the wrong answer – something that was actually going to happen should be recorded in the balance sheet. Philippe Danjou said he could go along with FASB’s idea. The best estimate notion was very useful when you came to amortise the asset. Bob Garnett said the IAS 37 measurement was not a static one – you reassessed it. So the weighted possibility was a better outcome, in his view. Warren McGregor said that was a fair point. He felt the best estimate approach was the best way to go, although it would need to be supported with indicators.

Jim Leisenring said this was only the first debate on the issue and the Board needed to understand all the implications of the approach. He would tentatively go along with FASB but wanted to explore all the alternatives. Mary Barth said she could see why she and Mr Leisenring were disagreeing – the term ‘best estimate’ was used in IAS 37 and what it meant was a probability weighted outcome. The difference was that IAS 37 was not contractual in nature so there was nothing limiting the possible outcomes. Ms Knuble said FASB were not thinking of the IASB definition of best estimate but of an on/off switch notion.

David Tweedie asked for a vote on question 3 in the paper, on whether the assessment of the lease term should be based on whether it is reasonably certain that the option will be exercised. The Board voted by 12 to 1 against (Jan Engström voting in favour).

The final section of the paper discussed the factors to be considered in determining the lease term. Staff were recommending that any guidance should be consistent with current practice, ie it should specify that all relevant factors except lessee intent and past practice should be taken into account. The Board agreed.

### Contingent rentals

Jeff Nickell of the FASB staff introduced agenda paper 13C, which discussed contingent rentals. The issue had been discussed at the FASB and IASB meetings in October 2007, where no agreement had been reached. The paper, he said, discussed the advantages and disadvantages of a new approach to accounting for contingent rentals. Some people believe that a new approach is necessary because the current model is not conceptually sound, believing that most contingent rental payments should be recognised at the inception of a lease. A new approach would address concerns that the current model would allow for both the right of use asset and the liability recognised to be minimised if the lease contract includes a significant element of contingent rentals.

He said that at its discussion, FASB had decided not to retain the IAS 17 approach but to include contingent rentals in the measurement based on a best estimate, which would not be a probability weighted amount. Danielle Zeyher of the FASB staff added that FASB defined best estimate as expected outcome. Rachel Knuble said it was akin to a mode approach – if there was a 60% chance you will pay out an amount, that was the most likely outcome. Ms Zeyher said FASB wanted a principle for the option term and contingent rentals that were similar. Mr Nickell added that FASB had indicated that it would consider an IAS 37 approach if that was the IASB’s decision.

He asked the Board if it wanted to retain the IAS 17 approach. (no-one did). David Tweedie asked if the Board wanted to adopt an IAS 37 approach (it did).

### Measurement of lessee's rights and obligations

Danielle Zeyher introduced agenda paper 13D. The right to use the asset meant that the asset should be recorded on the lessee's balance sheet, she said, and the next question was how you measure that asset. Fair value may not be easy to do because there was no observable market. Staff were recommending the measurement be on the same basis as the current measure for finance leases, ie initial measurement is at the lower of the obligation to pay rentals and the fair value of the leased item.

Jim Leisenring said he did not disagree but he did not like the notion of 'lower of' because it suggested bias. Warren McGregor asked if the impairment test would pick up any overpayments if the contracted amounts were used. Rachel Knubley said it would, assuming there was an impairment test trigger. David Tweedie asked what was FASB's position. Danielle Zeyher said it was that initial measurement should be the best estimate of the expected lease payments. Mary Barth said her preference would be for fair value on both sides but she would go along with FASB. She did not like the idea of 'lower of' either. David Tweedie asked if the Board wanted to go with the present value of payments (It did).

Danielle Zeyher moved on to question 3 and whether the current guidance for discounting the minimum lease payments should be retained. FASB had decided that the payments should be discounted using the lessee's secured incremental borrowing rate. The Board liked this idea and agreed.

Moving on to subsequent measurement, Ms Zeyher said staff were recommending that the IAS 17 approach be applied, and the right of use asset be depreciated over the lease term (para 25 of the paper). She noted that there was an alternative view (para 23) which was to amortise the asset using mortgage amortisation based on initial accounting, using the incremental borrowing rate. She said FASB had discussed both views and had discussed whether there should be classification criteria. Some FASB members felt that including rental expense in the income statement made more sense, but the Board did not reach a consensus.

David Tweedie asked if anyone liked the alternative view (they did not). Mary Barth asked how the staff saw their recommendation coming together. The recommendation seemed to be that the right of use asset went to IAS 16, or you consider it as the right to use what. If it was an intangible, it went to IAS 38. This theory was speaking to revaluation and other things, she said. Rachel Knubley said staff were clearly not going to write an impairment standard so they were looking at ways of dealing with the issue. Cross reference to other standards was one option.

David Tweedie asked the Board if it agreed with the staff recommendations in paras 25 to 28 (question 4). It did. He asked whether the revaluation issue had already been dealt with when the Board discussed the property sector. That was a huge issue in some parts of the world, he said. Warren McGregor said it had come up in the annual improvements project and the Board had agreed to change the language in IAS 16 so there was the option to revalue. Wayne Upton said he had heard that that had not

solved the problem. David Tweedie said that was clearly something that would need to be looked at.

David Tweedie asked if anyone disagreed with the final question (question 6, para 33), that payments for the minimum lease payments be apportioned between a finance charge and a reduction of the outstanding liability. (no-one did).

#### Lease classification

Agenda paper 13E discussed whether the Board wanted to retain the classification of leases as financing and operating. FASB had debated whether to retain the classification, said Ms Knubley, in order to allow in substance purchases to be shown separately. Staff believed it would be a significant simplification to eliminate the classification and were recommending that the distinction be abolished. The Board agreed.

Friday 25 July 2008

#### STANDARDS ADVISORY COUNCIL

Alan Teixeira said they thought it was helpful to indicate what the next steps were in relation to the Standards Advisory Council (SAC). At the last meeting much of the agenda time had been taken up with the constitutional review, although the SAC had also debated the two agenda proposals. They had discussed the potential agenda for the next meeting in November. They had indicated that they wanted to review progress on the conceptual framework.

#### FAIR VALUE MEASUREMENT

Hilary Eastman said that there were three papers arising from the standard by standard review of fair value in the existing IASB literature. The third paper (11B) had not been made available to observers. She was going to ask the Board to make a decision on the measurement of fair value. She had not, in the paper, discussed highest and best use, principal market and day 1 gains because she thought these were a separate issue from entry and exit values. However if Board members thought they needed to discuss those first, could they indicate that (no-one said anything).

The next steps would be to deal with the issues of highest and best use, principal market, day 1 gains, transfer or settlement, blockage and bid-ask spreads. They planned to hold three round tables in December, one in London, one in North America, and one in Asia. The staff intended to prepare a staff draft of the ED ahead of the round tables so that constituents could discuss this.

#### Measurement objective

Ms Eastman moved on to Paper 11A. The Board had decided in October 2007 that the staff should conduct a standard by standard review of fair value in existing standards to see whether in all cases it was exit value. This was intended to help decide whether to replace it with more specific labels. Currently fair value was defined as an exchange amount, and this permitted it to be used in a wide range of circumstances. A

narrower definition could reduce its use. Paragraphs 8-22 gave the staff analysis. They thought that you should get the same price for fair value defined as an exit price as if it were defined as an entry price.

The staff had set out two approaches. Approach 1: fair value was defined as a current exit price. If this was not appropriate, such as at initial recognition, they could use the transaction price as the best evidence of an exit price in the circumstances or not use fair value. Approach 2: they could abandon the term 'fair value' and replace it with current entry price and current exit price. Paper 11B contained examples of how this would look in relation to existing standards.

Tatsumi Yamada asked for a clarification that in the same market, entry prices and exit prices were the same. He asked if there were cases where transactions happened but in different markets. Ms Eastman said the most obvious was financial institutions that had access to different markets. They bought in one market, re-packaged, and sold in another market. Mr Yamada noted that there could be a unit of account issue as well.

Jim Leisenring remarked that he did not have any problems with the staff analysis. He accepted that entry and exit prices were the same in the same market, but he could not accept that that did not matter. He thought that the exit price was often in a different market. Most people did not have access to the market they bought in. The analysis was OK but he did not agree with the implications. Ms Eastman said that Approach 1 did not assume that all transactions happened in the same market. Fair value was a current price between market participants. People liked the expression entry price but what they were after was the transaction price.

Mr Leisenring added that if he chose to buy his Mercedes in Connecticut, that was his entry price. It might be the prices were a little lower in Oregon, but for him they were different markets. For him the local price was the price in the most advantageous market. When they said the entry price was not what you paid, that meant you had to search in other elsewhere. David Tweedie remarked that Approach 1 was a transaction price. Ms Barth noted that once you had figured out which market you were in, entry and exit price were the same.

Mr Leisenring responded that the market you transacted in is your entry price, full stop. The staff were saying, knowing full well it was not true, we will let you use your entry price as an exit price. Mr Cooper asked why the exit price was different. Mr Leisenring replied that he knew if he bought a Mercedes he could not sell it for the price he had just paid. It was an observable fact. Mr Cooper said he was thinking of the second hand market. Mr Leisenring said there was no alternative.

Mr Cooper said it was an important test. Was the exit price the second hand price or was it some other value? Ms Eastman said if he was suing the car in the business, it was an in-use value. Mr Cooper asked why the value of the car in the business would be different from the entry value. Ms Barth said that selling the car was in a different market. Mr Leisenring said he did not see why they had to put people through this convoluted reasoning. He did not see why they did not use two labels.

Ms Barth said she supported Approach 1. She thought there had been a lot of confusion about entry and exit prices. The staff had clarified this. Once you figured out what market you were in and what asset, the prices were the same. It shifted the question to the market. Mr Leisenring said he could not disagree more. He thought it was the opposite. They had said record at fair value, which was defined as exit price, but it was his exit price, and he could not exit in that market. Ms Barth said that SFAS 157 told you all you needed to know.

John Smith remarked that he agreed with Mr Leisenring: using entry and exit prices provided clarity. He had spent a lot of time with SFAS 157. He thought there was a better way to do it. Mr McGregor said he was all for clarity. Maybe the FASB would agree they could have said more about not having to go around looking for a price. He thought there was an increasing understanding of fair value and it would worry him if they moved to a new term. People were coming to terms with the literature.

Mr Garnett said he was all for clarity too. He thought the staff had done some excellent work. For him the best way of communicating was to describe the measurement objectives. Initial measurement was at entry price, but the problem area was subsequent measurement at exit price. The credit crunch had highlighted that. Having two different definitions would aid clarity in people's minds. They were concerned about recognising an immediate loss on purchase.

Mr Cooper indicated that he preferred approach 1. He thought it was crazy to get rid of a term that was now becoming recognised. The price only dropped if you dealt in a different market. Mr Leisenring observed that there were some markets he could not transact in. he did not care whether they did 1 or 2 but he agreed with Mr Garnett.

Hilary Eastman asked if they needed to talk about principal market before they decided this issue. Mr McGregor asked if they switched to liabilities would they have the same argument. Philippe Danjou took the view it was an opportunity to use precise terms and get rid of the emotional term 'fair' value. 'Current exit' was neutral.

Tatsumi Yamada asked, if he bought a car, on day 2 it became second hand. This applied to factories, manufacturing and so on. The day 2 price was from the second hand market. Ms Eastman replied that she did not think that you always bought and sold in different markets. They did not value cars at fair value anyway, it was cost at initial recognition. You would only use fair value in a business combination.

Wayne Upton remarked that they seemed to have this conversation a lot. They had different views about what the unit of account was and how it changed, and what the principal market was. Until they nailed that down they were talking about different things. Mr McGregor asked if they had a paper on principal market. Ms Eastman said it was coming in September. Ms Barth observed that there had been a lot of confusion about fair value two or three years ago, but SFAS 157 had helped a lot. People were getting their minds around it.

Jim Leisenring asked if he would value assets in a business combination in a market where he could sell them. Mr Cooper said that was not the case, it would be in the market where you use them. Mr Leisenring said the in use valuation was based on management intent. David Tweedie pointed out that under IFRS 3 you used exit price

if you were going to sell them but in use valuation if you were not. He said that in his mind, the minute he used fair value he had a loss. His exit price was not the same. Mr Cooper said his exit was to use the asset. The in use valuation premise produced replacement cost in nine cases out of ten.

Mr Engström commented that this discussion among fairly well-informed people showed how difficult the subject was for constituents. He thought Approach 2 was the only way for people to understand what they were doing. He thought David Tweedie was really in Approach 2 but preferred transaction price to entry price. Ms Eastman remarked that current entry price and transaction price were not necessarily the same thing. Current entry price was a transaction between market participants. David Tweedie said eh thought they should come down to something simple: transaction or entry price at initial recognition and when you re-measure fair value or value in use.

Ms Barth pointed out that SFAS 157 said you had to look at how you were going to enjoy the economic benefits. If you were planning to sell it, it was the exit price. If you were planning to use it, it was an in use valuation. They were both market values. Mr Upton suggested it would be better to say highest and best use. The in use premise was selling to someone who would use the asset the same way. Mr Engström responded that in most cases you could not sell it. 80% of industrial assets could not be sold, you could only use them.

Wayne Upton noted that it was difficult to keep things straight in one's mind when talking about value in use and the in use valuation premise. Mr Leisenring observed that they had asked that question in the invitation to comment and people said they ere comfortable with the difference. They could just do SFAS 157 and have an opportunity to explain. They did have the opportunity to learn from SFAS 157's communication failures. David Tweedie thought they had to deal with initial recognition separately. They decided to take a coffee break and then ask the staff what they wanted to do.

After the break Ms Eastman circulated to the board a diagram she had used for an internal meeting (not given to observers). She asked members to take Approach 1 and define fair value as exit value and go through the diagram. Mr Leisenring said he was willing to go through the exercise but it was confusing – there was no mention of in use valuation.

Mr McGregor said they should say fair vale was exit price and then in the existing standards replace it with another term if the standard did not mean exit price. Mr Gélard asked if they would also say exit price and entry price were the same. The chairman said they should not get into that. Ms Barth said she still thought they would have to look at each standard. David Tweedie said the staff would bring this back. He thought they should talk about both selling price and in use valuation. Otherwise it was too cryptic. They would not get a different answer. Mr Upton added they need to stress it was a price not a value.

Ms Eastman asked for confirmation that they were defining exit price as fair value and change the definition to refer to how they intended to generate economic benefit. She said she would write this up for *Update*. Mr McGregor said not to worry about that, Mary Barth and he edited it.

## RESTRUCTURING IFRS 1

David Tweedie said they would now discuss Paper 15, one of the best he had ever read. Tricia O'Malley reminded the Board that they had put out a re-structured version of IFRS 1 in the exposure draft of the annual improvements round of 2007. It had been taken out of the process because of time constraints and they now wanted to move to a final standard but they had to include subsequent amendments to the standard. They considered that everything in the updated version had already been balloted, either in the 2007 ED or the subsequent amendments to IFRS 1, and they need not bring it back to the Board again. They would issue two versions: a marked-up one and the edited text. She thought the Board would not disagree with the proposal of doing less.

Bob Garnett said he took it the staff were sure they were not changing any meaning, just the wording. He wondered what the European Commission's view would be – would they want to re-adopt it? (Mr McGregor objected that it was not just the European Commission, Mr Garnett replied that they were the ones that complained a lot). Ms O'Malley said she had looked again at the comment letters and they were generally agreed on the re-structuring. There were one or two minor comments about possible omissions. All the subsequent amendments to IFRS 1 would preserve the wording of the amendment.

Philippe Danjou thought it should make no difference to the European Commission as long as the substance was the same. Mr Garnett noted it was not the Board saying it was the same. Jim Leisenring asked what was the downside of saying they were going to ballot and putting it on the website. Mr McGregor said his feeling was that if anyone had any reservations about due process they should ballot it.

David Tweedie agreed: he said they would re-ballot it.

## Education session

Tuesday 22 July 2008

### LIABILITIES AND EQUITY

Liesel Knorr thanked the IASB for the opportunity to have another debate on liabilities and equity. She introduced Andreas Barckow, a member of the German Accounting Standards Board and Martin Schmidt the project manager from the GASB. She explained that within Europe EFRAG was trying to promote debate on some issues, and individual national standard-setters took the lead. This one was being led by the GASB.

Andreas Barckow started by noting that some people might question why there was another session by Germany on equity and liabilities. (Warren McGregor interjected with the observation that it was not just *some* people.) Mr Barckow continued, saying that the staff had asked the equity team to update the Board on changes to the project

since they had last seen it. He added that the presentation fell into three sections and he would prefer to take questions at the end of each section.

### Cross-cutting issues

He explained that he wanted first to make some general remarks (slide 3: slides available as observer notes). They needed to ask who were the primary users of the financial statements. The conceptual framework said these were investors, while the revised framework talked about capital providers. The second question was whose perspective should govern the presentation: should this be the entity or the legal owners or the capital providers? The third question (second on the slide) was whether there were distinct attributes that could be attributed only to equity or to liabilities?

There were also some questions that did not need to be answered before the distinction between debt and equity was established. They had not properly addressed either measurement or disclosure. They believed these questions were important but not primary. They also did not believe that there was an inherent link between the income statement and the balance sheet. There were dichotomies in both statements but they were not necessarily linked. The question of whether you upheld or abandoned dichotomies could be dealt with separately. He thought that the FASB took the view that part of equity should be re-measured.

He noted (slide 5) that the IASB had at least three projects that were linked to debt and equity. In Phase B of the Framework project there was a definition of assets and a mirror definition of liabilities. This needed to be consistent with the definitions in IAS 32 of financial liabilities and IAS 37 for non-financial liabilities. Phase D of the Framework addressed the reporting entity and related to whether a proprietary view or entity view was appropriate and also dealt with the group. The Financial Statement Presentation project addressed the structure of the statements.

His fourth general remark was that every business had to have some equity. They were focussing on business entities. The capital provided to found the entity should be in equity. This could not be done under current law, there were for example cooperatives and partnerships that did not have equity as such. But people found it counter-intuitive not to have some equity.

His fifth point (slide 7) was that they had tried to test the FASB's models in the European market, but it was not that easy. It was not clear that they defined convertibles and preferred stock in the same way. They believed there was something wrong with IAS 32 – it reached a conclusion that was counter-intuitive. In that model equity was not defined. It would be defined in the new model and they had tried to do that in their model. They would in principle go for the claims approach, but this had not been operationalised yet and so they had chosen a compromise. There was an example of its application.

Slide 8 was the key, in their view, to distinguishing debt and equity. They had tried to lay out what people thought were debt or equity characteristics. This showed that they were both multi-dimensional. You could not use a single criterion as a dividing line. There were nine criteria here, no one of which could be used. This was why their preferred solution was a claims approach. The details of their analysis were on slides

9 and 10. They believed that all the criteria were useful, but if you asked equity to meet all of them, you had a very narrow definition of equity. They believed that loss absorption covered several criteria but not all. They thought that loss absorption was intuitively used by users. He noted that the IASB's Financial Instruments working group also thought it was important.

David Tweedie asked whether the FABS was also trying to make its approach work in other jurisdictions. Ron Lott replied that they had tried but they did not know all the legal constraints on other jurisdictions. The chairman remarked that the FASB had tried to address the dimensions in slide 8. Mr Barckow agreed, but added that the difference was with loss absorption they had a sort of waterfall, where the FASB had a dividing line.

Jim Leisenring remarked that he accepted that IAS 32 was flawed. He had lived through excruciating debates on puttable instruments. But he thought the European proposal had the same flaw. An instrument that had a fixed value going in and going out did not absorb losses. John Smith said they should look at page 87 of the paper (not available to observers). Mr Barckow replied that they had identified three different points where loss absorption was an issue. As long as the losses were distributed, people were absorbing them. Mr Leisenring observed that in liquidation even accounts payable were loss-absorbing.

Paul Ebling (EFRAG) asked if they were not losing sight of what the session was trying to achieve. They could have a similar session on any of the three FASB models. The idea was to question the split between debt and equity and to try to work out an approach that captured what seemed to be useful. He thought they were going in too quickly to try to kill an approach rather than look for the seeds of good ideas. They seemed to be trying to kill the model before Mr Barckow had even presented it.

Mr Smith remarked that he just did not agree with loss absorption where equity could be a fixed figure. When permanent equity was 100 and puttable equity was 100, Mr Barckow said they had a buffer of 200, but he could only see 100. He thought they disagreed on what was loss absorption.

Steve Cooper noted that for the analyst the issue with debt was an assessment of credit risk, and for equity it was the value of the company. He appreciated that this could get murky, but he did not have an answer to that. He shared the view that this was all about the income statement and he did not see how this could be settled without looking at the related issues. He thought the claims model was appealing but wondered if that did not mean the problems were then shifted to the income statement.

### The loss absorption principle

Mr Barckow said he did not want to repeat everything he had said 15 months previously. The basic ideas were in slide 12. Equity was risk capital that was available for loss absorption. There were definitions in slides 13 and 14. There were different notions of what were losses and they had chosen accounting losses. Slide 16 addressed classification. This was done at inception and re-classification occurred only if the terms changed. There should be split accounting for instruments that were

not fully loss-absorbing. Slide 17 gave three types of instrument that were partly loss absorbing, depending upon different triggers. The entity needed to establish (slide 18) whether there was a gap in loss absorption.

Jim Leisenring said he did not know what happened with instrument 3 (slide 17). Suppose he estimated the loss at 2% and it was actually 80%. He saw operational problems galore. The one thing every jurisdiction had in common was the ingenuity to make liabilities look like equity. Mary Barth agreed that she also did not think it would work. You could structure round it.

Mr Barckow agreed that you could structure around it. The issue was that they wanted to figure out all the capital that was available for loss. The easy answer was just to say it was not loss-absorbing. Did they ignore the conditionality or did they take account of it? Closing the door was an easy answer, but was it the right answer?

John Smith said it seemed to him that by adding a sentence you made something equity. A debt to Mary where she agrees it may not be repaid under certain circumstances becomes equity. Mr Barckow argued that when the legal equity was gone, Mary's debt changed its nature. Ms Barth observed that she did not have any choice if the company had no money to pay her. Every claim was potentially loss-absorbing. David Tweedie asked for clarification: if Ms Barth agreed to absorb losses and not sue the company, it was equity, whereas if she did not agree not to sue, it was debt?

Steve Cooper suggested they were only half way there with loss absorption. For him, unlimited upside was an essential part of equity. Commercial paper then went away. He also thought that preventing structuring was a poor reason to end up in basic ownership. If you wanted to prevent structuring, you should remove the presentational issue. Mr Leisenring observed people would continue structuring as long as it made a difference to the income statement. He added that equity must have loss-absorbing characteristics but he did not think this was robust enough.

#### Other issues

Mr Barckow said he accepted their comments. Constituents had also given other comments. Equity and debt were multi-dimensional and there was no single characteristic that separated them. Slides 19 and 20 looked at the question of the entity perspective and the proprietary view. The second issue related to the group context. All of the approaches hit problems when they moved from the single company to the group. Slides 22/23 gave an example. Were non-controlling interests (NCI) equity or not? Under loss absorption they were not equity because NCI did not absorb any group losses.

Ms Barth observed that the parent did not absorb the losses of subsidiaries either. Mr McGregor added that IAS 27 was built on the notion of the economic entity. Mr Leisenring noted that NCI did not have residuality but they did absorb losses. It was another example of where loss absorption was not tough enough. Mr Smith said it did not seem like a buffer when someone could get out ahead of you. Wei-Guo Zhang asked whether the team had considered whether distributions might appear in the income statement. Mr Barckow said they had not focused on that but he could

envisage that as a possibility. Mr Zhang asked if this was the case even for the true owner. Mr Barckow asked who was the true owner? Mr Leisenring said if €100m were put in a special investment vehicle but the bank guaranteed the receivables, who was the owner?

David Tweedie observed they were running out of time. He noted that the FASB had three models and they had plumped for basic ownership. The IASB had not decided which characteristics of slide 8 were significant. He asked Mr Barckow to specify which determinants were essential. He said participation in losses, participation in the liquidation excess, the type of claim and subordination.

Mr Lott, asked which were part of the FASB's basic ownership approach, said the first six were all covered, 7 was not precluded, 8 he was not sure about and voting rights were not essential. Martin Schmidt said he had read the approach as having subordination as the only requirement. Mr Upton said he thought Mr Lott was talking about what was subsumed within that approach. David Tweedie said he was trying to contrast the two to see where the problems were. John Smith said if he had a put instrument under basic ownership, it would have to share in losses. Ron Lott agreed that if you could get out a fixed amount it could never be equity. Mr Schmidt agreed that if it was a fixed amount it could not be loss-absorbing. Mr Leisenring remarked that he did not then know what they had been talking about for the last hour and fifteen minutes.

David Tweedie said he would like some clarification. Firstly was profit participation deemed to be an essential characteristic? The cut did not seem clear yet. At default, everything became loss absorbing. Mr Barckow said it came back to the same point: the characteristics were multi-dimensional. Ms Barth suggested that basic ownership was really a claims approach that took them to the very bottom tier. Doing more was too hard. Mr Leisenring said it was difficult but he thought the issue was that it was too arbitrary. David Tweedie suggested that it would be helpful if the European team could prepare a paper showing how their approach differed from the FASB's basic ownership. Mr Barckow observed that they struggled with how basic ownership was defined. Some instruments were excluded.