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*Decisions become final only after completion of a formal ballot to issue a Standard or Interpretation or to publish an Exposure Draft.*

The International Accounting Standards Board met in London on 20 – 22 February, when it discussed:

- Business Combinations II
- Insurance contracts
- Financial statement presentation
- Annual improvements process
- Financial instruments
- Liabilities and Equity
- Conceptual framework
- Post-employment benefits

## Business Combinations II

### Assets subject to an operating lease when the acquirer is the lessor

The Board discussed the accounting in a business combination for an operating lease in which the acquirer is a lessor, that has favourable or unfavourable terms. The Board had previously asked the staff whether the favourable or unfavourable terms of the operating lease should be recognised separately from the related asset (see *Update*, May 2006). The Board tentatively decided that in a business combination an acquirer should measure and recognise an asset that is subject to an operating lease in which the acquirer is the lessor at its acquisition date fair value considering the terms of leases in place at the acquisition date. As such, a separate asset or liability would not be recognised if the lease is favourable or unfavourable. The Board observed that this conclusion was consistent with existing guidance in IAS 40 *Investment Property*. Given that the Board is likely to consider this issue again in the Fair Value Measurements and Leases projects, the Board tentatively decided not to deviate from the guidance in IAS 40 at this time.

### Reassessments

The IASB and IFRIC have received requests to provide guidance on whether, and in what circumstances, a business combination triggers a reassessment of the acquiree's classification or designation of assets, liabilities and contracts acquired or assumed in a business combination.

The Board asked the staff to continue to try to develop a principle that could be included in the business combinations standard.

### Proposed amendments to IAS 27

The Board continued its deliberations on the proposed amendments to IAS 27 *Consolidated and Separate Financial Statements*. The Board tentatively decided:

- (a) to add guidance in IAS 27 that the attribution of profits or losses and other changes in equity to controlling and non-controlling interests should be based on relative ownership interests. If the controlling and non-controlling interests have entered into a contractual agreement that requires profits, losses or other changes in equity to be attributed differently, the attribution should be based on the requirements of that agreement.
- (b) to affirm the proposal in the IAS 27 Exposure Draft to continue allocating losses in excess of the non-controlling interest in the equity of a subsidiary to the non-controlling interest, even if that would result in non-controlling interest being reported as a deficit.
- (c) to provide guidance in IAS 27 in the form of principle-based indicators that can be used to determine whether multiple arrangements (transactions) should be accounted for as a single transaction or arrangement.
- (d) to affirm the proposal in the IAS 27 Exposure Draft on the accounting for a loss of significant influence or joint control. IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* should be amended to require that on the loss of significant influence or joint control, any investment remaining in a former associate or joint venture should be remeasured to its fair value with a

gain or loss recognised in profit or loss.

### Transition provisions for the business combinations standard and revised IAS 27

The Board tentatively reaffirmed the proposal that the business combinations standard should be applied prospectively to business combinations for which the acquisition date is on or after the date that the standard is effective.

Retrospective application of the standard to acquisitions completed before the effective date should be precluded. The business combinations standard and the revised IAS 27 should be applied at the same time and at the beginning of the same annual period. However, earlier application of the business combinations standard and the revised IAS 27 would be allowed. The exposure draft included one exception to the prospective accounting principle: it proposed that contingent liabilities recognised in a business combination for which the acquisition date is before the application date of the new business combinations standard would need to be reassessed. The Board tentatively decided to remove that exception.

The Board also considered the transitional provisions in the proposed amendments to IAS 27 and tentatively reaffirmed them, except for the proposed requirement to recast prior period financial statements for decreases in a parent's controlling interest that do not result in a loss of control that occurred before the revised IAS 27 is applied. Those transactions will be accounted for prospectively.

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## Insurance

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The Board discussed whether an insurer should unbundle the deposit component of an insurance contract, and reached the following tentative conclusions:

- if the components are so interdependent that the components can be measured only on an arbitrary basis, the phase II standard on insurance contracts should apply to the whole contract.
- if the components are not interdependent, the phase II standard should apply to the insurance component and IAS 39 should apply to the deposit component.
- if the components are interdependent but can be measured separately on a basis that is not arbitrary, IAS 39 should apply to the deposit component. The whole contract would be measured by applying the phase II standard. Consequently, the insurance component would be measured as the difference between the measurement of the whole contract and the measurement of the deposit component.

The Board also discussed members' comments on a pre-ballot draft of the discussion paper on insurance contracts and instructed the staff as follows:

- The discussion paper should note that the Board has not identified significant differences between current exit value, as described in the draft, and fair value, as defined in the recent standard, SFAS 157 *Fair Value Measurements*. The discussion paper addresses several issues that would arise in applying level 3 of the hierarchy in SFAS 157. The Board published a discussion paper on fair value measurements in November 2006, seeking views on the definition of fair value in SFAS 157 and related guidance. Until the Board has completed its projects on insurance contracts and fair value measurements, it will not be in a position to reach a conclusion on how fair value should be defined or whether current exit value and fair value are the same or different.
- Estimated cash flows used to estimate the current exit value of insurance contracts include the servicing costs that market participants would incur for contracts with the same characteristics, including the level of service provided to policyholders and the approach to claims management. Those characteristics affect the future cash flows that market participants would consider. For example, aggressive, but expensive, claims management will lead to low claims but high expenses. Similarly, the level and type of service might affect lapse rates.
- In January 2007, the Board had decided tentatively that each cash flow scenario used in measuring a universal life contract should include interest credited at the rate that the insurer estimates will apply in that scenario, rather than the contractually required minimum. At this meeting, the Board clarified that the crediting rate in each scenario would be the rate that the insurer estimates it would pay in that scenario to the extent that a legal or constructive obligation exists.

### Next steps

The Board approved the discussion paper, subject to drafting. Two Board members made their approval conditional on a clear articulation in the paper of their concerns about the Board's preliminary views on the treatment of future cash flows relating to policyholder exercise of contractual options.

The Board expects to publish the discussion paper around the end of March. The comment period will be 180 days.

## Financial statement presentation

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The Board discussed the presentation of information about liquidity, particularly information about the short-term and long-term nature of assets and liabilities.

The Board asked the staff to explore whether the notion of solvency should be included in the working principle that states 'the financial statements should present information in a manner that helps a user assess the liquidity of an entity's assets and liabilities (nearness to cash or time to conversion to cash).'

The Board was in general agreement with the direction of the staff's recommendation that an entity should provide the following information in the financial statements:

- qualitative information about its liquidity management policy and processes
- details of maturities of its long-term assets and liabilities with contractual maturities.
- details of maturities of its short-term assets and liabilities as described below:
  - (a) If an entity manages its needs for cash on the basis of a period shorter than one year, the detailed maturities of assets and liabilities with contractual maturities should be provided for more than one time band (similar to what is required by IFRS 7 *Financial Instrument: Disclosures*, for financial liabilities).
  - (b) If an entity does not manage its needs for cash on the basis of a period shorter than one year, the maturity information may be provided either on the face of the statement of financial position or in the notes. However, if the entity presents the information in the statement of financial position, each of its assets and liabilities should be classified as either short-term or long-term.

An entity that manages its needs for cash on the basis of a horizon shorter than one year should classify the maturities of all its assets and liabilities having contractual terms by either:

- the shorter of the contractual maturity and the expected realisation or settlement of the asset or liability; or
- both (i) the contractual maturity and (ii) the expected realisation or settlement of the asset or liability, provided that it is consistent with the entity's liquidity management activities. Under this approach, any major differences between (i) and (ii) should be explained.

Otherwise, maturity information should be based on the shorter of (a) the contractual maturity and (b) the expected realisation or settlement of the asset or liability.

The Board asked the staff to revise those recommendations so that it is clear how the information is similar to or different from the requirements in IFRS 7.

## Annual improvements process

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The Board discussed three topics for inclusion in the annual improvements process. The process is intended to eliminate inconsistencies between standards and to clarify wording. Proposed amendments to standards resulting from the process will be published in a single exposure draft each year. The first group of proposed improvements will be published in October 2007.

### **Additional biological transformation in IAS 41 *Agriculture***

IAS 41 requires biological assets to be measured at fair value. In some circumstances, these fair values are measured using discounted cash flows. Paragraph 21 of IAS 41 excludes from such calculations increases in cash flows arising from 'additional biological transformation'. Interpretations of this requirement have differed, leading to diversity in practice. Therefore, the IFRIC recommended that the Board remove from IAS 41 the reference to 'additional biological transformation'. The Board accepted the recommendation and proposes to amend IAS 41 accordingly.

### **Status of implementation guidance**

The Board was told that some constituents interpret IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* as requiring the mandatory application of implementation guidance. The Board confirmed that implementation guidance is non-mandatory, but decided to amend IAS 8 to make this clear.

### **Restructuring of IFRS 1 *First-time Adoption of International Financial Reporting Standards***

IFRS 1 has been amended several times to accommodate first-time adoption requirements resulting from new standards or amendments to standards. Because of the way IFRS 1 is structured, such amendments are making the standard more complex and less clear. As more amendments become necessary, this problem will become worse. The Board discussed a proposal to restructure IFRS 1 without amending it to place transitional provisions relating to specific standards in appendices to the Standard. The Board accepted the proposal and directed the staff to draft a restructured version of IFRS 1.

## Financial instruments

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### **Definition of a derivative**

The IFRIC received submissions asking whether a contract that is indexed to revenue or earnings before interest, tax, depreciation and amortisation (EBITDA) of a party to the contract meets the definition of a derivative in IAS 39 *Financial Instruments: Recognition and Measurement*.

Paragraph 9 of IAS 39 excludes from the definition of a derivative contracts indexed to non-financial variables that are specific to a party to the contract. IFRSs do not define financial and non-financial variables. Consequently, the IFRIC concluded that it was unclear whether a contract that is indexed to an entity's own EBITDA or revenue meets the definition of a derivative.

At its meeting in January 2007 the IFRIC referred the issue to the Board and recommended that the Board exclude from the definition of a derivative in IAS 39 only contracts that are within the scope of IFRS 4 *Insurance Contracts*.

The Board noted that the exclusion from the definition of a derivative in IAS 39 was introduced when IFRS 4 was issued.

The Board confirmed that it had intended that only contracts within the scope of IFRS 4 should be excluded from the definition of a derivative. The Board also noted that IAS 39 excludes from its scope contracts that within the scope of IFRS 4.

The Board concluded that the exclusion from the definition of a derivative of contracts that are linked to non-financial variables that are specific to a party to the contract was unnecessary. Therefore, the Board tentatively decided to delete the exclusion as part of the annual improvements process.

## Liabilities and Equity

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The Liabilities and Equity project is a modified joint project being led by the FASB during the research stage. The FASB is planning to publish a preliminary views paper presenting the results of that research. The IASB aims to publish a discussion paper at around the same time, which will include the FASB's preliminary views paper. At this meeting the staff presented the results of the FASB research.

The staff presented the definition of equity, interaction of the models with the *Framework* and comparison of the models with regard to linkage and separation criteria, initial and subsequent measurement, substantive features, presentation in equity, classification on consolidation, reassessment and reclassification. No decisions were made.

## Conceptual framework

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The Board discussed the implications of replacing the liabilities and equity elements with a single element, tentatively called claims, and whether the staff should continue to develop this approach. The Board was divided in its views about the approach, with insufficient support for either continuing to develop the approach or doing no further work. The Board resolved to readdress development of the claims approach after the FASB's discussion of this same matter, including consideration of the implications for its Liabilities and Equity project.

The Board also discussed the comment letter analysis related to the Discussion Paper, *Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information*. The Board and the FASB will begin their redeliberations of these topics by discussing issues related to the qualitative characteristics at their April 2007 meetings. The boards plan to commence redeliberations for the objective of financial reporting at their June 2007 meetings. The IASB agreed not to hold a roundtable to discuss issues related to stewardship. Rather, the Board will consider other forms of meetings to discuss the stewardship issue.

## Post-employment benefits

The Board discussed a draft section of a discussion paper setting out the tentative decisions on recognition and presentation made at its meeting in November 2006. At this meeting, the Board tentatively decided that the discussion paper should set out presentation proposals in the context of IAS 1 *Presentation of Financial Statements*.

The Board also tentatively decided that all changes in the post-employment benefit obligation and in the value of plan assets should be recognised in comprehensive income in the period in which they are incurred. The discussion paper should explain that the Board's preliminary view is that all changes should be recognised in profit or loss. The discussion paper should also offer two alternatives to this approach:

- service costs and actuarial gains and losses on the defined benefit obligation except those arising from changes in the discount rate, recognised in profit or loss. Interest cost, changes in the discount rate and all changes in plan assets recognised outside profit or loss.
- service cost, interest cost, actuarial gains and losses on the defined benefit obligation, except those arising from changes in the discount rate, dividends received on plan assets, and interest earned on plan assets (using the current rate inherent in the fair value) recognised in profit or loss. Changes in the discount rate and other changes in the fair value of plan assets recognised outside profit or loss.

### Cash balance and similar plans

The Board continued its discussion of the accounting for cash balance and similar plans. The staff put forward tentative definitions in respect of the three categories of post employment benefit promises as follows:

- A defined contribution promise is one for which the entity has no further obligation in respect of current and prior periods once the defined contributions have been paid into a separate fund. These promises are to be accounted for in accordance with the requirements of IAS 19 for defined contribution plans.
- An asset-based promise is one whose amount changes in response to the change in an asset or index, other than assets or indices that yield fixed increases. These promises are to be measured at fair value.
- All other promises are for defined benefits. Typically, defined benefit promises change in line with specified fixed increases, service or salary. These promises are to be measured in accordance with the requirements of IAS 19 for defined benefit plans.

The Board tentatively decided that benefit promises with fixed increases should be treated as asset-based rather than as defined benefit. The staff will bring a paper discussing the implications of such an approach at the next meeting.

The Board also tentatively decided that residual benefit promises (ie those that are not asset-based, defined contribution or related to service and salary) should be treated as defined benefit. Furthermore, defined benefit and defined contribution benefit promises should be accounted for in accordance with the current IAS 19 accounting requirements for defined benefit and defined contribution plans respectively and asset-based benefit promises should be measured at fair value.

In respect of the approach to be used, the Board tentatively decided that plans should be separated into defined benefit, defined contribution and asset-based promises, where

applicable. Furthermore, the hierarchy of identification of the benefit promises would be defined benefit then asset-based then defined contribution promises.

### Meeting dates: 2007

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

#### 2007

19—23 March

16—20 April

23—24 April (joint with FASB)

14—18 May

18—22 June

16—20 July

17—21 September

15—19 October

22—24 October (joint with FASB), Norwalk, Connecticut, USA

12—16 November

10—14 December