

# IFM accounting standards

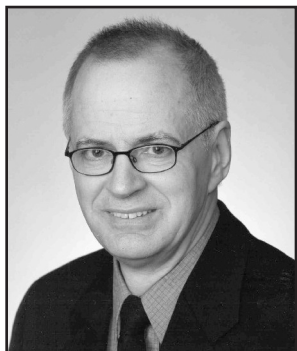
ACTIVITIES OF THE CANADIAN ACCOUNTING STANDARDS BOARD AND STAFF

JULY 2008

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## MESSAGE FROM THE CHAIR



### INFLUENCING THE INTERNATIONAL ACCOUNTING STANDARDS BOARD

Steps are well underway to ensure that the changeover to International Financial Reporting Standards (IFRSs) for publicly accountable enterprises goes smoothly in 2011. This decision means that Canada (like every other country adopting IFRSs) is, in effect, relying on the IASB for the primary development of accounting standards. The IASB is a full-time standard setting body based in London, England. Its work is overseen by Trustees who ensure, among other things, that the IASB adheres to the rigorous and extensive

due process mandated by its Constitution. The Constitution was carefully crafted to ensure that the IASB remains independent of national, regional and other vested interests. The IASB has been critically acclaimed for being one of the most transparent organizations of its type in the world. You don't have to be in London to follow the action. The deliberations of the Board and the progress on its projects can be easily monitored worldwide via the internet.

I am often asked "What influence will Canada have over the IASB?" Based on my personal experience over the last twenty years, I have found the IASB and its predecessor body to be very receptive to new ideas and fresh perspectives. What carries the debate is the logic and coherency of the arguments, rather than rhetoric, lobby efforts and political interference. We can't influence if we don't participate. And we need to do that now because the projects currently underway will affect us. The AcSB intends to play an active role as a facilitator to ensure that Canadians have a strong voice. How much influence will Canada have? It ultimately depends on you.

*Paul Cherry*

See our website at [www.acsbcanada.org](http://www.acsbcanada.org) for the most recent information on activities in progress.

## **IASB DISCUSSION PAPERS AND EXPOSURE DRAFTS CURRENTLY OUTSTANDING**

The IASB often publishes a Discussion Paper as its first publication on a major new topic to explain the issues and solicit early comments from stakeholders. A Discussion Paper may include:

- a comprehensive overview of the issue;
- possible approaches in addressing the issue;
- preliminary views on which of these approaches a standard should take; and
- an invitation to comment.

Recently, the AcSB discussed the importance of commenting to the IASB on proposals in a Discussion Paper. The issuance of a Discussion Paper is the point in a project when fundamental decisions are often made about the accounting approach to be taken in the eventual standard (for example, whether the measurement basis for an asset is cost or fair value). The IASB considers the responses to the Discussion Paper in determining the accounting approach to be used. By the time an Exposure Draft is issued, the general approach has largely been decided and, therefore, it is less likely that the IASB will change fundamental decisions at that stage. The Exposure Draft focuses on more detailed issues related to the chosen approach and provides constituents with the opportunity to provide input on the issues, as well as on the draft wording of the proposed standard. The AcSB concluded that it is important for it, and for Canadian constituents, to respond to IASB discussion documents if they are to influence the direction of future IFRSs.

In March 2008, the IASB issued three Discussion Papers:

- Financial Instruments with Characteristics of Equity;
- Reducing Complexity in Reporting Financial Instruments; and
- Preliminary Views on Amendments to IAS 19 Employee Benefits.

In May, the IASB issued a Discussion Paper, “Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity.”

The IASB also issued an Exposure Draft in May 2008 — “An improved Conceptual Framework for Financial

Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information.”

Discussion Papers and Exposure Drafts form important steps in the IASB’s development of a standard. As a result, the AcSB encourages stakeholders to review these documents (and other discussion documents as they are issued in the future) and to respond directly to the IASB — visit [www.iasb.org](http://www.iasb.org) (see “Open to Comment”). For an overview of these discussion documents, AcSB staff have prepared the following brief write-ups on each.

### **AMENDMENTS TO IAS 19 *EMPLOYEE BENEFITS***

Financial statement users and preparers have criticized the reporting of post-employment benefit promises for failing to provide high-quality, transparent information. For example, the deferred recognition model has been criticized for not reflecting the economic reality of these promises in the financial statements. Improvements to address these criticisms are now on the way.

The IASB has embarked on the first phase of a two-phase project to provide financial statement users with better information about post-employment benefit promises. As part of this first step, the IASB issued a Discussion Paper, “Preliminary Views on Amendments to IAS 19 *Employee Benefits*,” that has very significant implications for both balance sheet and income reporting. It proposes to eliminate deferred recognition and smoothing so that the full amount of the post-employment defined benefit obligation, net of plan assets, is reported in the balance sheet. But, where are changes in the value of the post-employment defined benefit obligation and plan assets presented? The proposals consider several approaches for presentation, including having all changes recognized in profit or loss and having certain elements recognized in other comprehensive income.

The proposals go beyond defined benefit promises to consider a new category — contribution-based promises, which would replace defined contribution plans. Contribution-based promises are those where the benefit to the employee is based on specified contributions by the employer and may include a promised return on the

contributions (often called cash-balance plans). Some plans currently accounted for as defined benefit plans would be reclassified as contribution-based promises. The Discussion Paper proposes that the liability for contribution-based promises be measured at fair value.

The proposals also consider classification, recognition and measurement of “higher of” promises (employees’ option of receiving the higher of a defined benefit promise or a contribution-based promise), including separately recognizing and measuring the option at fair value.

Given these significant implications for both balance sheet and income reporting of post-employment benefit promises, stakeholders are encouraged to read the Discussion Paper (available from the IASB’s website) and respond by September 26, 2008..

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#### **CONCEPTUAL FRAMEWORK: THE OBJECTIVE OF FINANCIAL REPORTING AND QUALITATIVE CHARACTERISTICS**

This project is the first of eight phases to develop a converged and improved conceptual framework common to both the IASB and FASB. The framework will be used by both Boards as a basis for setting accounting standards and is also referred to, in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, as a reference point when accounting standards do not address particular issues.

The IASB’s Exposure Draft, “An improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information” includes the following key proposals.

##### *Objective of financial reporting*

- Identifies the primary user group of general purpose financial reporting as present and potential capital providers, who include equity investors, lenders and other creditors.
- Is broad enough to encompass all the decisions that primary users make in their capacity as capital providers, including resource allocation decisions as well as decisions to protect and enhance their investments (or stewardship type decisions).

- Is prepared from the perspective of the entity rather than the perspective of its owners or a class of owners.

##### *Qualitative characteristics*

- Identifies relevance and faithful representation as two fundamental characteristics and comparability, verifiability, timeliness and understandability as enhancing characteristics.
- Fundamental characteristics distinguish information that is useful from that which is not useful and misleading. *Relevant* information is capable of making a difference by virtue of its predictive or confirmatory value. *Faithful representation* (which replaces reliability because it is a commonly misunderstood term) depicts the substance of an economic phenomenon completely, neutrally and without material error.
- Enhancing characteristics help to provide information that is more useful and should be maximised to the extent possible. *Comparable* (including consistent) information enables users to identify similarities in and differences between two sets of economic phenomena. *Verifiable* information provides credibility that the information represents what it purports to represent. *Timeliness* provides information when it has the capacity to influence decisions. *Understandability* is the quality of information that enables users to comprehend its meaning.

##### *Constraints*

- Identifies *materiality* and cost as two pervasive constraints.

The IASB and FASB are requesting comments by September 29, 2008. The IASB Discussion Paper and FASB Preliminary Views are available from their respective websites. The framework chapters are expected to be effective on or after the Canadian adoption of IFRSs in 2011.

For adoption into Canadian GAAP, the AcSB expects to issue an exposure draft of these proposals in July 2008.

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#### **CONCEPTUAL FRAMEWORK: THE REPORTING ENTITY**

A further phase in the IASB/FASB project to develop an improved and converged conceptual framework

addresses the nature of the reporting entity. This phase is to develop a conceptual foundation to serve as the basis for resolving issues that arise in standards-level projects or in accounting practices for consolidated financial statements.

The IASB's "Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity," includes the following key proposals.

#### *The reporting entity concept*

- Should be broadly described as a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers.
- Should not be limited to business activities that are structured as legal entities, thus, can include a sole proprietorship, corporation, trust, partnership, association and a group of entities.

#### *Composition of a group entity*

- Determine by primarily using the controlling entity model.
- Should be based on control when control over another entity entails both power over that entity and the ability to obtain benefits.
- Determine control by assessing all of the existing facts and circumstances.
- Considers some circumstances in which the common control model may provide useful information to equity investors, lenders and other capital providers. Application of the common control model should (or may) be considered at a standards level.

#### *Parent entity financial reporting*

- Present general purpose consolidated financial statements from the perspective of the group reporting entity. However, adopting this approach does not preclude including in financial reports information that is primarily directed to the needs of a particular group of capital providers, such as parent company shareholders.
- Explains how consolidated financial statements meet the objective of financial reporting by providing useful information to equity investors, lenders and other

capital providers. However, proposes that the conceptual framework should not preclude the presentation of parent-only financial statements, provided they are included in the same financial report as consolidated financial statements.

The IASB and FASB are requesting comments by September 29, 2008. The IASB Discussion Paper and FASB Preliminary Views are available from their respective websites.

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#### **FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY**

After more than ten years of deliberation, the FASB has issued its Preliminary Views on defining equity instruments. The IASB Discussion Paper proposes that the FASB document be used as the basis for jointly developing an improved common standard on equity/liability classification and related issues. The proposals have very significant implications for both balance sheet and income reporting. The next step in this project will likely be a joint IASB/FASB Exposure Draft.

Three possible approaches to defining equity instruments are proposed for consideration:

- The "basic ownership" approach — which would restrict equity to what are considered to be the most basic ownership instruments.
- The "ownership-settlement" approach — which would include, in addition to basic ownership instruments, all instruments issued by the entity that have no settlement requirements ("perpetuals") and most instruments that will be settled by delivery or receipt of a basic ownership instrument.
- The "reassessed expected outcomes" (REO) approach — which would further expand the definition of equity to include all instruments or components that have a return that varies with the fair value of basic ownership instruments.

The FASB prefers the basic ownership approach, which is the simplest and easiest to implement. However, the FASB concludes that "there is no natural line that is

obvious to all.” Major conceptual issues include the treatment of puttable common shares, derivatives on the issuer’s basic ownership instruments, and perpetuities — and there are some potentially troublesome implications for the definition of a “liability”. Major practical issues include the relative complexity of the approaches and their susceptibility to structuring instruments to obtain a desired classification.

The IASB is requesting comments by September 5, 2008. The IASB Discussion Paper and the FASB Preliminary Views documents are available from the IASB website.

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### **REDUCING COMPLEXITY IN REPORTING FINANCIAL INSTRUMENTS**

Are standards for reporting financial instruments too complex? Many believe that they are, and have been urging the IASB and FASB to develop new standards that would be more principle-based and simpler. Canadian requirements for reporting financial instruments are now similar to those of the IASB and FASB.

This IASB Discussion Paper has been designed to gather information to assist the IASB in deciding how it may improve and simplify its standards on financial instruments. The FASB has issued a similar Discussion Paper for comment by its constituents.

The IASB Discussion Paper analyzes the problems with existing financial instrument standards, and proposes that they are caused in large part by the many ways in which financial instruments are measured. It proposes that the long-term solution is to measure all financial instruments at fair value, but it recognizes that some significant issues and concerns need to be addressed before such a requirement could be put in place. The Discussion Paper addresses concerns that are commonly raised about fair value measurement, and it sets out the issues that the IASB believes must be resolved before fair value could become a general standard.

In the meantime, the Discussion Paper proposes a number of possible “intermediate approaches” that might be undertaken to reduce today’s complexity. These include reducing the number of financial instrument measurement categories, replacing existing requirements with a general fair value measurement principle with some optional exceptions, and eliminating or simplifying aspects of hedge accounting.

This Discussion Paper represents a significant initiative in two respects. First, it attempts to respond to concerns about the complexity of existing financial instrument standards. Second, it sets out, and requests support for, the joint IASB/FASB vision that the long-term solution is to measure all types of financial instruments at fair value.

The IASB is requesting comments by September 19, 2008. The Discussion Paper is available from the IASB website.

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### **YES, THE IFRSs ARE AVAILABLE IN FRENCH!**

The rumours are not true: while the IASB recognizes only the English version as “approved”, there exists an official French translation of the IFRSs. The standards are translated by the IASC Foundation, an organization which oversees the IASB. In anticipation of the transition to IFRSs, the AcSB has recently issued, in the form of an Exposure Draft, both the English and the French versions of the 2007 IFRS.

Stakeholders who use the French version of the IFRSs are invited to inform the AcSB of any problems with the meaning and understandability of the French translation of the IFRSs and related material. Comments will be analyzed and submitted to the IASC Foundation for correction as required. Please send your comments to the AcSB at [ed.accounting@cica.ca](mailto:ed.accounting@cica.ca).

For the French version of the IFRS Exposure Draft, go to [www.cncanada.org/download.cfm?ci\\_id=44313&la\\_id=2&re\\_id=0](http://www.cncanada.org/download.cfm?ci_id=44313&la_id=2&re_id=0).

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**WHO'S NEWS**

Former AcSB member Jean Paré has been appointed to the IASB's International Financial Reporting Interpretations Committee (IFRIC), effective June 30, 2008. Jean is Vice President, Financial Reporting, Bombardier Inc.

IFRIC is the IASB's interpretative body which reviews accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance. The primary objective of IFRIC is to obtain consensus on the appropriate accounting treatment for the issues reviewed.

For more details on IFRIC visit [www.iasb.org/About+Us/About+IFRIC/About+IFRIC.htm](http://www.iasb.org/About+Us/About+IFRIC/About+IFRIC.htm).

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