INTERNATIONAL FEDERATION OF ACCOUNTANTS

545 Fifth Avenue, 14th Floor Tel: (212) 286-9344
New York, New York 10017 Fax: (212) 286-9570
Internet: http://www.ifac.org

DATE:	16 JUNE 2004
MEMO TO:	MEMBERS OF THE IFAC PUBLIC SECTOR COMMITTEE
FROM:	LI LI LIAN
SUBJECT:	UPDATING THE PREFACE

ACTION REQUIRED

The Committee is asked to:

- **review** the changes made to the Preface; and
- **provide directions** to staff on further updates/revision to the Preface.

AGENDA MATERIAL:

		Pages
12.11	Updated *Preface to IPSASs*	12.335 – 12.340

BACKGROUND

PSC's Preface to IPSASs

The *Preface to IPSASs* was issued in May 2000. The structure of PSC's Preface is similar to the former IASC's *Preface to Statements of International Accounting Standards* which was approved in November 1982. In many places, the PSC's Preface deals with issues in a similar manner to the IASC. However:

- the PSC's Preface includes an extra section to explain that IPSASs will deal with both the accrual and cash bases of accounting and to explain in more detail the authority of IPSASs; and
- the IASC's Preface has more information on the role of its consultative group and the relationship between IASC and IFAC.

PSC Meeting in March 2004

At the Buenos Aires meeting, the PSC noted that it should update its *Preface to IPSASs* to reflect developments that have taken place since the Preface was first issued. The changes will also include policy changes made as a result of the Improvements Project:

- All paragraphs in the standard are of equal authority. The black letter paragraphs will deal with the main principles. This policy is harmonized with the IASB's policy in its Preface and in each of its improved IASs or new IFRSs.
- The PSC will now include a "Basis for Conclusions" on major issues and, if the PSC decides that certain requirements in IPSASs should depart from the equivalent requirements in IAS/IFRS, the reasons for such a departure.

Staff were directed to prepare a draft Preface for consideration at the July 2004 meeting.

Staff were also directed to review the language used in "grey letter" paragraphs in current IPSASs. Staff note that in most cases, the language in grey letter is not imperative except where referring to a "black letter" requirement or a definition - "may" or "encouraged" is used to refer to circumstances where there is an option for additional disclosure and "should" or is/are is used to illustrate requirements in IPSASs.

PSC External Review
The final report of the PSC Review Panel was sent to the IFAC Board for their consideration in early June. Staff have noted the sections of the Preface that may be impacted if the Review Panel recommendations are adopted by the IFAC Board.

Harmonization Strategy Paper
In this meeting, the PSC will also consider an IAS/IFRS harmonization strategy paper. A number of the recommendations in that strategy paper may impact the Preface. Staff have also noted the sections of the Preface that may be impacted by the PSC's decisions on the IAS/IFRS harmonization strategy.

ISSUES AND STAFF VIEWS

(i) The Revised IASB Preface
The IASB approved for issue an updated Preface in April 2002. The structure of the IASB's new Preface is substantially different from the previous version. In addition, the new Preface has:

- included an explanation of the role of the International Financial Reporting Interpretations Committee (IFRIC) and the Standards Advisory Council (SAC);
- explicitly noted that the IASB's objective is to reduce the number of alternate treatments for transactions and events;
- removed explanation that IASs should be complied with in all material respects (materiality is now dealt with in IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*);
- quoted from IAS 1 to emphasize that an entity's financial statements should not be described as complying with IASs unless they comply with all the requirements of each applicable Standard and each applicable Interpretation;
- noted that paragraphs in bold type (black letter) and plain type (grey letter) in IFRSs have equal authority. The paragraphs in bold type indicate the main principles, and individual standard should be read in the context of the objective stated in the standard in and the IASB's Preface. (Please note: the IASB updated this policy to add that an individual standard should also be read in the context of the *Framework for the Preparation and Presentation of Financial Statements*);
- outlined the possible steps involved in the due process;
- added a new section on the timing of application of IFRSs. This section explains that new or revised IFRSs will only be effective from a date specified in the document and transitional provisions may be provided to constituents; and
- eliminated paragraphs stating that IASs promulgated by the IASB do not override local regulations governing the issue of financial statements in a particular country.

Staff Recommendation
The PSC should include in the *Preface to IPSASs* the PSC equivalent of the following matters dealt with in the updated IASB Preface:

- stating that an entity's financial statements should not be described as complying with IPSASs unless they comply with all the requirements of each applicable IPSAS;
- clarifying the role of the PSC's consultative group;
- publishing any dissenting opinions held by PSC members as part as PSC's due process; and
- adding a section on the timing of application of IPSASs.

Staff do not propose that the PSC's Preface include other issues introduced in the IASB's Preface as they are not relevant to the PSC.

Staff also propose that the PSC consider including a paragraph explaining the role and authority of the different types of PSC publications. (This issue was also included in the IAASB's *Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services*.)

(ii) Timing of Update of Preface and Issue of an ED Proposing Amendments to PSC's Preface?

Staff Recommendations

Staff are of the view that it is not necessary to expose amendments to the Preface to reflect the developments that have occurred since the Preface was first issued. The changes can be fed into the PSC's 2005 handbook. (The changes have been marked-up in the attached Preface.) They include:

- that the Cash Basis IPSAS' primary financial statement is now the statement of cash receipts and payments;
- the availability of agenda materials to the public;
- the use of Project Advisory Panels and Steering Committees as part of the due process; and
- that the IASB has now replaced the former IASC.

As noted above, the results of the PSC's External Review and the PSC's harmonization strategy may impact the Preface. Furthermore, IASB is reviewing its own deliberative procedures (due process). (The IASCF is also currently conducting an external review of its constitution, but it is anticipated that that review may take some time to complete.) Accordingly, staff are of the view that:

- The introductory section of the General Improvements Project ED should alert readers that as a consequence of the IASB harmonization policy the black and gray letter paragraphs in the improved IPSASs will have equal authority.

- The updated PSC's Preface should be exposed at the end of 2005 (or later if necessary) to encompass the IFAC Board's decisions on the recommendations of the PSC's External Review, the PSC's harmonization strategy, the equal authority issue, and any issues which emerge from PSC deliberations. The finalized updated Preface will then be included as part of the 2009 suite of IPSASs as mentioned in the harmonization strategy.

Li Li Lian
TECHNICAL MANAGER

PREFACE TO INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

This Preface sets out the objectives and operating procedures of the International Federation of Accountants — Public Sector Committee (the Committee) and explains the scope and authority of the International Public Sector Accounting Standards (IPSASs). The Preface should be used as a reference for interpreting the Exposure Drafts and Standards approved and published by the Committee.

Introduction

This section may be impacted by the PSC External Review

The Public Sector Committee

1. The Public Sector Committee is a standing committee of the Council of the International Federation of Accountants (IFAC) formed to address, on a co-ordinated worldwide basis, the needs of those involved in public sector financial reporting, accounting and auditing. In this regard "public sector" refers to national governments, regional governments (for example, state, provincial, territorial), local governments (for example, city and town) and related governmental entities (for example, agencies, boards, commissions and enterprises). The Committee has been given the authority to issue IPSASs on behalf of the Council.

2. At present, governments and other public sector entities follow widely diverse financial reporting practices and, in many countries, there are no authoritative standards for the public sector. In some countries where standards do exist, the body of standards may be either at an early stage of development or limited in application to specific types of entities in the public sector.

3. The Committee issues a range of publications including International Public Sector Accounting Standards (IPSASs), Guidelines, Studies and Occasional Papers. Further details of these publications are provided in the section of the IFAC Handbook, "~~Introduction to the Public Sector Committee of the International Federation of Accountants~~Summary of Other Documents." The Standards are the authoritative requirements established by the Committee to improve the quality of financial reporting in the public sector around the world.

The Public Sector Committee's Consultative Group

To reflect that the PSC has started and activated its Consultative Group. The IASB also notes the role of its Standards Advisory Council (SAC) in its Preface.

4. The Public Sector Committee's Consultative Group is an electronic forum for interested parties to give their views and opinions on public sector financial reporting developments and issues. The Consultative Group is a non-voting group, but provides a means by which the Committee can consult with and

seek advice as necessary from a broad constituent group. The Group is chaired by the Chair of the Public Sector Committee.

Objective of the Committee

Para 5: may be impactd by Externl Review

~~4~~5. The objective of the Committee is to develop programs aimed at improving public sector financial management and accountability including developing accounting standards and promoting their acceptance.

6~~5~~. In order to achieve its objective, the Committee ~~is~~ develops ~~ing a set of~~ recommended accounting standards for public sector entities worldwide. ~~Initially, t~~These Standards (the IPSASs) include Standards:

- based on~~are being developed by adapting~~ International ~~Accounting~~ Financial Reporting Standards (I~~A~~FRSs) issued by the International Accounting Standards Board (IASB) (formerly known as the International Accounting Standards Committee, IASC)~~ to a public sector context~~; and ~~.~~ ~~In undertaking that process, the Committee attempts, wherever possible, to maintain the accounting treatment and original text of the IASs unless there is a significant public sector issue which warrants a departure. In its ongoing work program the Committee also intends to develop IPSASs to~~
- dealing with public sector financial reporting issues that are either not comprehensively dealt with in existing I~~A~~FRSs or for which I~~A~~FRSs have not been developed by the IASB. Examples of these issues include the nature of the governmental reporting entity and recognition principles for tax revenue.

Maybe impactd by harmniz ation strategy

7. In developing IPSASs based on IFRSs, the Committee attempts, wherever possible, to maintain the accounting treatment and original text of the IFRSs unless there is a significant public sector issue that warrants a departure.

~~6~~8. In developing IPSASs the Committee considers and makes use of pronouncements issued by:

- the IASB;
- national regulatory authorities;
- professional accounting bodies; and
- other organizations interested in financial reporting, accounting and auditing in the public sector.

Para 9: to be updated when PSC develops its own conceptual framework

~~7~~9. As most IPSASs are based on ~~IASs~~IFRSs, the IASB~~C~~'s *Framework for the Preparation and Presentation of Financial Statements* is a relevant reference for users of IPSASs.

General Purpose Financial Statements

~~8~~10. Financial statements issued for users that are unable to demand financial information to meet their specific information needs are deemed to be general purpose financial statements. Examples of such users are citizens, voters, their representatives and other members of the public. The term "financial statements" used in this Preface and in the Standards covers all statements and explanatory material which are identified as being part of the financial statements.

~~9~~11. When the accrual basis of accounting underlies the preparation of the financial statements, the financial statements will include the statement of financial position, the statement of financial performance, the cash flow statement and the statement of changes in net assets/equity. When the cash basis of accounting underlies the preparation of the financial statements, the primary financial statement is the ~~cash flow~~ statement of cash receipts and payments. IPSASs apply to the published financial statements of public sector entities other than Government Business Enterprises.

Updated: reflect Cash Basis issued.

12~~0~~. In addition to preparing general purpose financial statements an entity may prepare financial statements for other parties (such as governing bodies, the legislature and other parties who perform an oversight function) who can demand financial statements tailored to meet their specific information needs. Such statements are referred to as special purpose financial statements. The Committee encourages the use of IPSASs in the preparation of special purpose financial statements where appropriate.

Accounting Standards

Authority of International Public Sector Accounting Standards

13~~1~~. Within each jurisdiction, regulations may govern the issue of general purpose financial statements by public sector entities. These regulations may be in the form of statutory reporting requirements, financial reporting directives and instructions, and/or accounting standards promulgated by governments, regulatory bodies and/or professional accounting bodies in the jurisdiction concerned.

1~~2~~4. IPSASs promulgated by the Committee do not override the regulations referred to above that govern the issue of general purpose financial statements in a particular jurisdiction. Some sovereign governments and national standard-setters have already developed accounting standards that apply to governments and public sector entities within their jurisdiction. IPSASs may assist such standard-setters in the development of new standards or in the revision of existing standards in order to contribute to greater comparability. IPSASs are likely to be of considerable use to jurisdictions that have not yet developed accounting standards for governments and public sector entities. The Committee strongly encourages the adoption of IPSASs and the harmonization of national requirements with IPSASs.

1~~3~~5. Standing alone, neither the Committee nor the accounting profession has the power to require compliance with IPSASs. The success of the Committee's efforts is dependent upon the recognition and support for its work from many different interested groups acting within the limits of their own jurisdiction.

1~~4~~6. The Committee believes that the adoption of IPSASs, together with disclosure of compliance with them will lead to a significant improvement in the quality of general purpose financial reporting by public sector entities. This, in turn, is likely to lead to better informed assessments of the resource allocation decisions made by governments, thereby increasing transparency and accountability.

IPSASs for the Accrual and Cash Bases

17~~5~~. The Committee ~~is~~ developsing ~~a set of~~ IPSASs which ~~will~~ include Standards applying to the accrual basis and has developed a separate IPSAS that ~~will~~ specifiesy the reporting requirements for the cash basis.

Para 17: may need to be updated because of Dev Assist cash basis IPSAS.

Moving from the Cash Basis to the Accrual Basis

1~~6~~8. The Committee envisages that some entities in the process of moving from cash accounting to accrual accounting may wish to adopt the requirements of particular accrual-based IPSASs during this process. An entity may voluntarily adopt the relevant disclosure provisions in an accrual-based IPSAS, although its core financial statements will nonetheless be prepared according to the IPSAS dealing with financial reporting under the cash basis of accounting. The status (for example, audited or unaudited) and location of additional information (for example, in the notes to the financial statements or in a separate supplementary section of the financial report) will depend on the characteristics of the information (for example, reliability and completeness) and any legislation or regulations governing financial reporting within a jurisdiction.

~~17~~19. The Committee attempts to facilitate compliance with IPSASs through the use of transitional provisions in certain Standards. Where transitional provisions exist, they allow an entity additional time to meet the full requirements of a specific accrual-based IPSAS. An entity may at any time elect to adopt the accrual basis of accounting in accordance with IPSASs. At this point, the entity should apply all the accrual-based IPSASs and could choose to apply any transitional provisions in an individual accrual-based IPSAS.

~~18~~20. Having decided to adopt accrual accounting in accordance with IPSASs, the transitional provisions would govern the length of time available to make the transition. On the expiry of the transitional provisions, the entity should report in full in accordance with all accrual-based IPSASs.

~~19~~21. International Public Sector Accounting Standard IPSAS 1 *Presentation of Financial Statements* requires disclosure of the extent to which the entity has applied any transitional provisions.

Scope of the Standards

22~~0~~. The Standards apply to all public sector entities including national governments, regional governments (for example, state, provincial, territorial), local governments (for example, city, town) and their component entities (for example, departments, agencies, boards, commissions), unless otherwise stated. The Standards do not apply to Government Business Enterprises. ~~The Committee has resolved that t~~These entities ~~should~~ apply ~~IAS~~IFRSs.

2~~1~~3. Any limitation of the applicability of specific IPSASs is made clear in those Standards. IPSASs are not meant to apply to immaterial items.

Authority of paragraphs in International Public Accounting Standards

IASB wording

24. Standards approved by the Committee include paragraphs in bold type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. An individual Standard should be read in the context of the objective stated in that standard and this Preface.

Due Process

2~~2~~5. The Committee issues Exposure Drafts of all proposed Standards for comment by interested parties including IFAC member bodies, auditors, preparers (including finance ministries), standard-setters, and individuals. The Committee will usually expose a proposed Standard for a reasonable time (normally at least 4 months) to allow for its constituents to consider and comment on its proposals. This provides an opportunity for those affected by the Committee's pronouncements to present their views before the pronouncements are finalized and approved by the Committee. The Committee considers all comments received on Exposure Drafts and makes such modifications as it considers appropriate in the light of its objectives.

2~~3~~6. The draft of a Standard, duly revised after the exposure period, is submitted to the Committee for approval. If approved by the Committee, it is issued as an IPSAS and becomes effective from the date specified in the Standard. On occasion, where there are significant unresolved issues associated with an Exposure Draft, the Committee may decide to re-expose a proposed Standard.

Para 27 may be impacted by the PSC External Review

2~~4~~7. For the purposes of approving an Exposure Draft or a Standard, each Committee member represented on the Committee has one vote. A quorum of nine members is required. If a Standard is approved by at least three-quarters of the total voting rights present at a meeting, the pronouncement is published and released. Exposure Drafts are approved by at least two-thirds of the total voting rights present at a meeting.

Intro sentence and 1st dot point reflects IASB wording

28. The Committee's due process for projects normally, but not necessarily, involves the following steps:

- publishing within an exposure draft a basis for conclusion;
- formation of a Project Advisory Panels (PAP) to give advice to the Committee on a project;
- formation of Steering Committees to issue Invitations to Comments (ITCs); and
- making agenda papers publicly available.

Language

Note: Different wordings for each of the IASB's Preface, IAASB's Preface, the Education Committee's Framework and the PSC's Preface reference to the language of approved publications.

~~25~~29. The approved text of any Exposure Draft or Standard is that published by IFAC in the English language. IFAC members are authorized and encouraged to prepare translations of Exposure Drafts and Standards, to be issued in the language of their own countries as appropriate. Where such translations are prepared, the official version is that published in the English language. These translations should indicate the name of the IFAC member body that prepared the translation and that it is a full translation of the approved text. Other organizations wishing to translate Exposure Drafts and Standards should first contact the IFAC Secretariat.

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DATE: 17 JUNE 2004
MEMO TO: MEMBERS OF THE IFAC PUBLIC SECTOR COMMITTEE
FROM: LI LI LIAN AND MATTHEW BOHUN
SUBJECT: **STATUS OF IASB PROJECTS AS AT MAY 2004**

ACTION REQUIRED

The Committee is asked to **note** the update on the IASB work program.

AGENDA MATERIAL:

BACKGROUND

This memorandum provides an update of developments in the IASB's work program since the PSC's meeting in Buenos Aires in February 2004. The information contained in this update is drawn from IASB Updates (February 2004 – May 2004) and a review of the IASB web site www.iasb.org as at June 16, 2004. Staff are of the view that some of the projects of the IASB not dealt with in this memo are less relevant to the public sector.

Staff have also compiled the Interpretations that have been issued and those that the IFRIC will issue intends to issue during the remainder of the year, and the issues currently being discussed by IFRIC in Appendix 2.

DOCUMENTS ISSUED RECENTLY

Documents issued by the IASB and IFRIC since February 2004 are:

	Month of Issue	**Document**
1	March 2004	IFRIC Draft Interpretation D5 "Applying IAS 29 *Financial Reporting in Hyperinflationary Economies*" (clarification on how an entity shall restate its financial statements for effect of hyperinflation) (comment period closed on May 14, 2004)
2	March 2004	Business Combinations Project Phase I • IFRS 3 *Business Combinations* • Revised IAS 36 *Impairment of Assets* • Revised IAS 38 *Intangible Assets*
3	March 2004	IFRS 4 *Insurance Contracts*

	Month of Issue	Document
4	March 2004	IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*
5	April 2004	Exposure Draft of Proposed Amendments to IAS 19 *Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures* (comment period closes on July 31, 2004)
6	April 2004	Exposure Draft of proposed amendments to IAS 39 *Financial Instruments: Recognition and Measurement--The Fair Value Option* (comment period closes on July 17, 2004)
7	April 2004	Exposure Draft of Proposed Amendments to IFRS 3 *Business Combinations: Combinations by Contract Alone or Involving Mutual Entities* (comment period closes on July 31, 2004)
8	May 2004	IFRIC Draft Interpretation D6 *Multi-employer Plans* (comment period closes on 9 July 2004)
9	May 2004	IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*

DOCUMENTS ANTICIPATED TO BE ISSUED IN THE REMAINDER OF 2004[1]

Documents anticipated to be issued by the IASB and IFRIC later in the year are:

	Document
1	IFRS XX *Exploration For and Evaluation of Mineral Reserves*
2	IFRS amending to IFRS 3 *Business Combinations* for combinations by contract alone or involving mutual entities
3	ED of IFRS to replace IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*
4	ED to amend IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
5	ED to amend IAS 20 *Government Grants and Disclosure of Government Assistance*
6	EDs emanating from Business Combinations Phase II – application of the purchase method
7	ED emanating from the “revenue and related liabilities” project
8	ED emanating from the consolidation (including special purpose entities) project
9	ED amending IFRS 4 *Insurance Contracts* to deal with financial guarantees and credit insurance
10	Discussion Paper on Accounting Standards for Small and Medium Entities (SMEs)
11	Draft Interpretation D7 *Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions*

[1] This is based on IASB’s timetable as of 1 March 04, IASB’s updates issued from March 04 to May 04 and the IFRIC’s updates issued from March 04 to June 04.

	Document
12	Draft Interpretation dealing with members' shares in co-operative entities
13	Draft Interpretation proposing to remove the scope exclusion in SIC-12 *Consolidation – Special Purpose Entities* related to equity compensation plans

PROJECTS

(i) Provisions, Contingent Liabilities and Contingent Assets

The PSC has issued IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, which is based on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The IASB has discussed amending IAS 37, if the IASB proceeds with this project, it will have implications for IPSAS 19. The IASB anticipates issuing the ED amending IAS 37 in the second quarter of 2004 together with EDs emanating from the second phase of the Business Combinations Project.

The main amendments to IAS 37 are:

- to withdraw existing guidance for provisions for restructuring costs (paragraphs 70 – 83) and to replace it with guidance that specifies the existence and announcement of a restructuring plan does not by itself create an obligation; and
- to amend the definitions of contingent assets and liabilities to:

> ***A contingent asset is a ~~possible asset~~conditional right that arises from past events ~~and whose existence will be confirmed only by~~ that may result in a future cash inflow (or other economic benefits) based on the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the ~~enterprise~~entity;***
>
> ***A contingent liability is***
>
> ***~~(a)~~ ~~a possible~~ conditional obligation that arises from past events ~~and whose existence will be confirmed only~~the outcome of which will be resolved by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.~~; or~~***
>
> ***~~(b) a present obligation that arises from past events but is not recognised because:~~***
>
> ***~~(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or~~***
>
> ***~~(ii) the amount of the obligation cannot be measured with sufficient reliability.~~***

- clarification of the definition of a "constructive obligation" such that for an entity to recognize an amount as a liability;
- clarification of the measurement requirements such that the amount an entity would rationally pay to settle an obligation should reflect the risks and uncertainties surrounding the obligation; and
- changing the title of IAS 37 to *Provisions and Contingent Liabilities*, because the requirements relating to unconditional rights accompanying contingent assets are in other IFRSs.

The IASB also noted that the scope of IAS 38 *Intangible Assets* should be amended to clarify that some unconditional rights accompanying contingent assets will be within its scope.

(ii) Revenue – Framework and IAS 18 *Revenue*

The PSC has issued IPSAS 9 *Revenue from Exchange Transactions* based on IAS 18 *Revenue*. The IASB's discussion on this issue may have implications for IPSAS 9. The PSC also issued ITC *Revenue from Non-exchange Transactions (including Taxes and Transfers)*. The IASB is continuing its consideration of revenue in the context of revising relevant sections of its *Framework for the Preparation and Presentation of Financial Statements* and replacing IAS 18. The IASB initially anticipated issuing an Exposure Draft in 2004; however, the current IASB timetable shows that the timing of this project is under review.

The PSC is currently monitoring the progress of the IASB's Framework.

The IASB is considering an approach to the recognition of revenue that focuses on changes in equity. Consequently, revenue is recognized when an increase in assets or a decrease in liabilities is recognized. In view of this approach the IASB has made a number of decisions about the recognition and measurement of assets and liabilities. The IASB has:

- confirmed its decision that contracts need to be enforceable before assets and liabilities can arise from them;
- decided to include guidance in the Standard on contract enforcement worthiness;
- tentatively decided that only obligations that are legally enforceable should be recognized;
- tentatively decided that legally enforceable obligations would include obligations currently described in the accounting literature as not being legal obligations, such as some "constructive obligations" and "equitable obligations"; and
- tentatively decided that in the absence of evidence to the contrary, all promises to customers should be presumed to be legally enforceable.

The IASB also tentatively decided that under the replacement Standard for IAS 18:

- a reporting entity should not recognize revenue for the performance by third parties of its obligations to deliver goods or render services to customers if those obligations are legally assumed by those third parties, however in all other circumstances a reporting entity should recognize revenue for the performance by third parties of its obligations to deliver goods or render services to customers; and
- non-reciprocal transfers received should not be excluded from revenue, and should be disclosed as a separate line item in income statements.

(iii) Consolidation (including special purpose entities)

The PSC has issued IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities* based on IAS 27 *Consolidated Financial Statements and Accounting for Controlled Entities*. The IASB's discussion on this issue may have implications for IPSAS 6.

The IASB continued to consider the definition of "control" as the basis for consolidation for <u>both</u> special purpose entities (SPEs) and non-SPEs. The IASB has tentatively decided that the concept of "control" should satisfy three criteria:

- the *power* criterion – the ability to dominate an entity's strategic operating and financing policy.
- the *benefit* criterion – the ability to access benefits; and

- the ability to use power so as to increase, maintain or protect the amount of those benefits.

The IASB discussed the circumstances in which an entity currently dominating policy determination of another entity is able to satisfy the power criterion. The IASB tentatively decided that:

- an entity with a current ability to determine strategic operating and financing policy meets the power criterion, provided that there is an absence of a third party that is able to dominate policy determination. For example, a significant minority shareholder that has been able to dominate policy determination can satisfy power criterion if the balance of holdings is dispersed and disorganized, but not if the balance is held by a passive majority shareholder; and
- an entity that does not dominate the determination of strategic operating and financing policy in practice, but that has the ability to dominate such determination, meets the power criterion. This is the case even if the entity has a history of not utilizing its ability to dominate or has no current intention of utilizing its ability. (This criterion is new in IAS 27, but has been addressed in, and is consistent with, the requirements in existing IPSAS 6.)

The IASB also discussed the nature of fiduciaries and how the concept of control should be applied to them. No decisions were made on this issue.

(iv) Financial Instruments

As noted above, the IASB has issued an Exposure Draft of proposed amendments to IAS 39 *Financial Instruments: Recognition and Measurement – The Fair Value Option*. The ED proposes that the option of measuring a financial instrument at fair value be limited to items where one of the following conditions is met:

- items that are financial assets or liabilities with one or more embedded derivatives;
- items that are financial liabilities whose cash flows are contractually linked to the performance of assets that are measured at fair value;
- the exposure to changes in the fair value of the financial asset or financial liability is substantially offset by the exposure to the changes in the fair value of another financial asset or financial liability including a derivative;
- the item is a financial asset other than one that meets the definition of loans and receivables; or
- the item is one that IAS 39 or another standard allows or requires to be designated as at fair value through profit or loss.

Additionally, the ED proposes that IAS 39 explicitly require that the fair value of the financial instrument be verifiable, that is, there must be external evidence of fair value available. The comment period for the ED closes on July 21, 2004.

The IASB has discussed amending IAS 39 in the context of several projects. In summary, the IASB:

- has considered amending IAS 39 to clarify whether gains and losses relating to a subsidiary that were recognized in equity should be recognized in profit or loss ("recycled") when the parent entity loses control of the subsidiary. The IASB decided that such gains and losses should be recognized in profit and loss;

- has decided to amend IAS 39 to ensure that entities are not required to recognize a profit immediately after initial recognition in relation to the acquisition of a financial instrument at a price lower than its observable market price;
- has decided to amend IAS 39 to clarify that a forecast intragroup foreign currency transaction can be used to hedge an external transaction that is denominated in the functional currency of the group provided that the transaction gives rise to an exposure that has an effect on consolidated profit and loss. The external transaction would be designated as the hedged item; and
- has confirmed its previous decision to issue an ED that relocates all disclosures relating to financial instruments from IAS 32 *Financial Instruments: Presentation and Disclosure* to a new IFRS. IAS 32 would only contain presentation requirements. As part of this process the current risk disclosures in IAS 32 would be replaced – see section (viii) below for details of this project.

The PSC workplan includes a fuller discussion of the strategy related to Financial Instruments at the November 2004 meeting. At that time Staff will present proposals for harmonizing IPSASs with the Financial Instruments Standards of the IASB.

(v) Reporting Comprehensive Income

The IASB and FASB both have individual projects on reporting comprehensive income. The IASB's comprehensive income project was initially a joint project between the IASB and the UK's Accounting Standards Board (ASB), however, this project was later included as part of the convergence project between the IASB (and the ASB) and FASB. In previous IASB Updates, Staff reported that the IASB, ASB (UK) and FASB (in this section, collectively known as the Boards) have formed a working group to research and form recommendations to reduce areas of divergence and develop a timetable for the release of public documents for this project.

In April 2004, the Boards met and agreed to form an international joint Advisory Group that will advise them and their respective staff, in the course of their individual projects (i.e. the FASB's and IASB/ASB's individual projects on reporting comprehensive income). On May 28, 2004, the Boards invited nominations to form the Advisory Group. The Advisory Group will have about 20 members, most of whom will be professionals having significant experience and responsibility for the preparation, analysis, audit, or regulation of financial statements of business enterprises. Nominations should be submitted by June 25, 2004.

In addition, at the April 2004 meeting, the Boards also agreed that the goals associated with the project have different characteristics such that the work should be performed in segments. The Boards expect to pursue both segments contemporaneously, although it is likely that Segment A will be resolved first.

Segment A includes:

- whether to require a single statement of comprehensive income that includes a subtotal similar to the concept of "net income from continuing operations" or "profit and loss";
- the required primary financial statements;
- the number of years required to be presented in comparative financial statements and related disclosures in the notes; and

- considering whether the direct method should be required for the presentation of the statement of cash flows.

Segment B includes:

- considering whether there is value in the notion of "recycling" items between the subtotals of net income and other comprehensive income and, if so, the basis for the types of transactions and events that should be recycled and when recycling should occur
- developing consistent principles for disaggregating information on each of the required financial statements; and
- defining the totals and subtotals to be reported on each of the required financial statements (that the statements might include, for example, categories such as business and financing).

A public discussion document on Segment A is anticipated to be published in the second quarter of 2005. There is no further update on when a document emanating from Segment B will eventuate.

(It should be noted that the IASB and FASB recently agreed to move towards an objective to have a single conceptual framework.)

(vi) IAS 20 *Government Grants and Disclosure of Government Assistance*

The PSC issued an Invitation to Comment (ITC) on non-exchange revenue (which includes taxes and grants) in January 2004. The IASB's discussion on this IAS may impact the PSC's consideration on non-exchange revenue.

There is no further update on this IAS apart from what was previously reported. That is, the IASB had tentatively decided to amend IAS 20 to reflect the requirements for government grants contained in IAS 41 *Agriculture*. Based on their timetable as of March 1, 04, it was anticipated an exposure draft amending IAS 20 to be issued in the second quarter of 2004. Staff believe, however, that the release of this ED may be deferred to the next quarter.

(vii) IFRS 3 *Business Combinations*

IAS 22 *Business Combinations* was part of the first stage of PSC's Standards Program for consideration by the PSC to develop an equivalent IPSAS. Consideration was deferred until the IASB has completed its review on business combinations.

The IASB is reviewing its Business Combinations project in two phases. The IFRSs/IASs related to Phase I were issued in March 2004 – IFRS 3 *Business Combinations*, improved IAS 36 *Impairment of Assets*, and improved IAS 38 *Intangible Assets*. Phase I seeks international convergence of existing standards on:

- the definition of a business combination;
- the appropriate method(s) of accounting for a business combination and for goodwill and intangible assets acquired in a business combination;
- the treatment of liabilities for terminating or reducing the activities of an acquiree; and
- the initial measurement of the identifiable net assets acquired in a business combination.

Phase II will include issues related to:

- the application of the acquisition method (previously known as purchase method). The IASB changed the name of this method to reflect the change from cost-based procedures previously associated with the purchase method with the acquisition method procedures now based on fair value. Both FASB and IASB are jointly considering the issue of acquisition method as part of their convergence project, and
- accounting for business combinations in which separate entities or operations of entities are brought together to form a joint venture, and
- possible applications for 'fresh start' accounting. 'Fresh-start' accounting derives from the view that a new entity emerges as a result of a business combination.

The IASB timetable indicates that an ED arising from Phase II will be issued in the second quarter of 2004.

(viii) Financial risk disclosures project

The IASB plans to issue an ED to replace IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* (ED IAS 30) in the second quarter of 2004. The IFRS arising from this ED is proposed to be applicable for accounting periods beginning on or after 1 January 2007, with early adoption encouraged.

As noted in previous IASB Updates, the IASB had decided to extend the scope of risk disclosures in IAS 30 to encompass all entities. In addition, ED IAS 30 will:

- propose replacing the risk disclosures in IAS 32 *Financial Instruments: Presentation and Disclosure* (equivalent IPSAS 15) and transferring them to the new Standard replacing IAS 30. The ED will also propose including guidance in the Standard to suggest ways to apply the risk disclosure requirements proposed in the Exposure Draft. This guidance would accompany but not be part of the IFRS;
- propose relocating all disclosures relating to financial instruments that are currently in IAS 32 to the Standard that replaces IAS 30. IAS 32 would only contain requirements for presentation (i.e. the debt/equity distinction and offsetting); and
- propose requiring further disclosures of fee income and expense, as an additional category of "significant items of income and expense" in IAS 32.

ED IAS 30 also proposes that:

- IAS 1 *Presentation of Financial Statements* (equivalent IPSAS 1) be amended to require disclosures about capital. ED IAS 30 will include an example of a capital disclosure for a non-financial institution; and
- the risk disclosures in IFRS 4 *Insurance Contracts* be amended.

Li Li Lian
TECHNICAL MANAGER

Matthew Bohun
TECHNICAL MANAGER

Appendix 1: IASB Timetable

The IASB's expectations as at 1 March 2004 about the timing of projects on its active agenda
Staff note: At the time of writing this report, publications marked with # have been issued by the IASB

	2004				2005
	Qtr 1	Qtr 2	Qtr 3	Qtr 4	
Amendments to IASs 32 and 39 *Financial Instruments* Macro hedging - limited amendment	IFRS#				
Financial risk and other amendments to financial instruments disclosures		ED			IFRS
Share-based payment		IFRS#			
Business combinations *phase I*	IFRSs#				
Business combinations: Scope of IFRS 3		ED#	IFRS		
Business combinations *phase II* Application of the purchase method		ED			IFRS
Reporting comprehensive income*					
Exploration for and evaluation of mineral resources	ED#			IFRS	
Insurance contracts *Phase I*	IFRS#				
Insurance contracts *Phase II*					ED
Concepts - revenue and related liabilities				ED	
Consolidation (including special purpose entities)				ED	
Short-term convergence of International Financial Reporting Standards and national accounting standards-					
Joint project with the FASB *phase I*					
- Asset disposals	IFRS#				
- IAS 37		ED			IFRS
Other convergence projects					
- Employment benefits*		ED#			IFRS
- Amendment/withdrawal of IAS 20		ED		[IFRS]	
Accounting standards for small and medium-sized entities*					
* timing under review					

Legend:
ED - Exposure Draft
IFRS - International Financial Reporting Standard (IFRSs include International Accounting Standards)

Appendix 2: IFRIC Update

IFRICs Issued

1. IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* issued in May 2004

Draft Interpretations Issued – comment period closed

1. IFRIC D3 *Determining Whether an Arrangement Contains a Lease* (issued on 15 January 2004, comment period closed on 19 March 2004)
2. IFRIC D4 *Decomissioning, Restoration, and Environmental Rehabilitation Funds* (issued on 15 January 2004, comment period closed on 19 March 2004)
3. IFRIC D5 *Applying IAS 29 Financial Reporting in Hyperinflationary Economies for the First time* (issued on 11 March 2004, comment period closed on 14 May 2004)

Draft Interpretations Issued – comment period outstanding

1. IFRIC D6 *Multi-employer Plans* (issued on 6 May 2004, comment period due on 9 July 2004)

Other issues currently being considered to issue Interpretations

1. Service Concession Arrangements – in respect to IAS 1 *Presentation Financial Statements*
2. Sale and leasebacks with repurchase agreements – in respect to IAS 17 *Leases*
3. Money purchase plans with minimum guarantee – in respect to IAS 19 *Employee Benefits*