Summary note of the Accounting Standards Advisory Forum

Held on 25 and 26 September 2014 at the IASB offices, Cannon Street, London

This note is prepared by staff of the IASB, and is a high level summary of the discussion that took place. A full recording of the meeting is available on the IASB website.

ASAF members attending

Kim Bromfield	South African Financial Reporting Standards Council
Clement Chan	Asian-Oceanian Standard-Setters Group
Françoise Flores	European Financial Reporting Advisory Group
Russell Golden	Financial Accounting Standards Board (US)
Lu Jianqiao	Chinese Accounting Standards Committee
Liesel Knorr	Accounting Standards Committee of Germany
Roger Marshall	Financial Reporting Council (UK)
Ana Martinez-Pina	Instituto de Contabilidad y Auditoria de Cuentas (Spain)
Linda Mezon	Accounting Standards Board of Canada
Yukio Ono	Accounting Standards Board of Japan
Angus Thomson	Australian Accounting Standards Board

Leases

1. The IASB staff presented an update on the status of the Leases project and mentioned that a Project Update, published in August 2014, had been distributed to ASAF members.

2. The EFRAG representative then provided ASAF members with an overview of the feedback received from recent additional consultation and a round-table meeting held in Europe on two aspects of the Leases project—the lessee accounting model and the definition of a lease. This additional consultation was conducted by EFRAG and the four large European standard-setters. In the light of the feedback received from this consultation, the EFRAG staff had prepared a paper for discussion at the ASAF meeting suggesting some changes to the proposed guidance on the definition of a lease. Those suggestions were to:

   (a) define a lease as a financing arrangement for the right-of-use asset for a period of time; and

   (b) to align the guidance on unbundling lease and service components with the guidance on unbundling in the Revenue Recognition Standard.

3. ASAF members had mixed views on the suggestions included in the EFRAG staff paper.

4. Regarding defining a lease as a financing arrangement, the following views were expressed:

   (a) One member fully supported the IASB retaining its definition and did not support basing the definition on financing.

   (b) One member supported the general aim of the financing suggestion, noting that mentioning financing would be helpful in distinguishing leases from services that require the use of assets.

   (c) Although agreeing that leases are often a form of financing, some members expressed the view that it is more appropriate to define a lease by focusing on obtaining a right of use. One member noted that, in a fully prepaid lease, there is no financing element. Nonetheless, assuming that a lessee obtains a right to use an asset, the transaction should be accounted for as a lease.

   (d) IASB members expressed concern about focusing on the form of the contract rather than on the substance. This could lead to many existing leases, including finance leases, no longer being considered to be leases. One member also expressed concern about the consequences for lessors.

   (e) Some members expressed concern about the suggestion to analyse the supplier business model as an indicator of the provision of financing. In their view, the business model of the lessor should not be of critical importance in assessing whether the transaction provides financing for a lessee, particularly for real estate leases.

5. Regarding unbundling different components of a contract, members generally supported consistency in outcomes between the Leases Standard and the Revenue Recognition Standard. A view was expressed that it might be appropriate to account for an entire contract as a service (ie not to unbundle) when the service component of a contract is substantially larger than the lease component.

6. In discussing the definition of a lease, the IASB staff noted that the objective of the project is to capture assets used by a lessee in its operations and any corresponding liabilities incurred in obtaining those assets. This is to provide better information about the capital employed in those operations and the leverage of the entity. In most cases, the recognition of a right-of-use asset also gives rise to a lease liability, because lease payments are made over time.

7. Finally, some ASAF members noted the importance of convergence between the IASB and FASB on leases.

Discount Rates research project

8. The IASB staff introduced the research project on discount rates, outlining the proposed scope and research approach to the project. ASAF members' views were sought on the scope and approach.

9. ASAF members generally supported the scope and the research approach; in particular, most agreed that identifying the measurement bases in each relevant Standard that requires or permits the present valuing of future cash flows would be one way of helping to identify appropriate discount rates. Suggestions from ASAF members included:

   (a) that the research should also look at the effect that the discount rate has on performance reporting;

   (b) considering the meaning of 'interest expense' and 'interest income' as reported in the income statement;

   (c) expanding the scope to consider discounting in IAS 2 *Inventories*, because it is not clear whether discounting could be applied in the measurement of inventories;

   (d) considering the requirements in IFRS 15 *Revenue from Contracts with Customers* with respect to discount rates; and

   (e) expanding the description and the scope of the project to address present value measurement as a whole (including cash flows), not merely discount rates, because all the aspects of present value calculations are inextricably linked.

10. ASAF members also emphasised the importance of interaction with the *Conceptual Framework* and the *Insurance Contracts* projects, although some noted that this work is intended to be at a level of detail that is not appropriate for the *Conceptual Framework*.

11. A few members expressed the view that some form of guidance on discount rates will be needed, because of difficulties involved with applying some of the current guidance. They were, however, happy to take a step-by-step approach as suggested by the IASB, starting with research.

12. An ASAF member also noted that the project might consider the prohibition on present valuing of future cash flows in IAS 12 *Income Taxes*.

Post-implementation Review IFRS 3 *Business Combinations*

13. ASAF members were provided with:

   (a) an update of the FASB activities related to the Post-implementation Review of Statement 141(R) and the accounting for goodwill arising from a business combination;

(b) a summary of the key comments received in response to the IASB's Request for Information *Post-implementation Review: IFRS 3 Business Combinations* (IFRS 3 PIR);

(c) an overview of the findings from the ASBJ/EFRAG/OIC paper on goodwill; and

(d) an overview of the findings from the FRC survey on intangible assets.

14. ASAF members had mixed views on the subsequent accounting for goodwill (ie an impairment-only model versus an amortisation and impairment model).

15. ASAF members highlighted other critical issues arising from the IFRS 3 PIR, including:

(a) the definition of a business;

(b) issues arising because of the absence of guidance on the accounting for business combinations under common control;

(c) the challenges in valuation of intangible assets when recognised separately from goodwill;

(d) the accounting outcome for the subsequent accounting for contingent consideration; and

(e) the accounting outcome for step acquisitions and loss of control.

16. The majority of ASAF members indicated the subsequent accounting for goodwill and the definition of a business are the most critical issues that the IASB should consider addressing as part of its agenda-setting process.

17. In relation to the definition of a business, some ASAF members were particularly interested in seeing greater clarity about the extent to which an acquisition needs to include the acquisition of processes as well as assets and/or liabilities in order for it to be a business acquisition.

18. In relation to the subsequent accounting for goodwill, many ASAF members suggested that the requirements of the impairment test should be improved and that this could be achieved by a review of IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*.

19. ASAF members generally supported maintaining convergence with US GAAP. Consequently, they suggested that any amendments to IFRS 3 should be discussed with the FASB.

Conceptual Framework

Update on the progress of the *Conceptual Framework* project

20. ASAF members were provided with a summary of the tentative decisions made by the IASB in the course of redeliberations on the *Conceptual Framework* project. In addition, the IASB staff

informed ASAF members about the discussion on the *Conceptual Framework* project at the September IASB meeting.

21. In general, ASAF members expressed support for the direction of the project. Some participants stated that the revised *Conceptual Framework* would better reflect the views of users of financial statements and would provide a better basis for understanding the IASB's thinking in developing Standards. That should help improve the acceptability of the Standards. However, some ASAF members expressed the following concerns:

    (a) the IASB has not sufficiently deliberated some of the more complex issues, such as the distinction between profit or loss and other comprehensive income (OCI), selection of measurement bases and definitions of liabilities and equity;

    (b) some updates seem to be based on current thinking and existing Standards-level projects, rather than on the development of underlying concepts;

    (c) the idea that prudence is consistent with neutrality may not be accepted by all constituents because some traditionally associate it with conservatism; and

    (d) the business model should be used more widely by the IASB as a tool when developing Standards to achieve more meaningful statements of financial position and performance.

22. IASB members emphasised that the IASB is not trying in the *Conceptual Framework* project to justify its previous decisions in Standards, and is not limited by those decisions. Instead, it is focusing on the issues that have proved difficult in recent years and is trying to draw out the concepts underlying those decisions.

Measurement

23. The purpose of this session was to seek feedback from ASAF members on the tentative decisions on measurement made by the IASB so far. ASAF members discussed:

    (a) cash flow-based measurement:

    - some ASAF members agreed with the IASB's tentative decision that the purpose of cash flow-based measurement techniques is normally to implement one of the measurement bases that will be described in the *Conceptual Framework;*

    - other ASAF members stated that cash flow-based measurement could be described as a third measurement category instead of merely as a technique to estimate other measurement bases. This could be particularly helpful for subsequent measurement and could help categorise measurements that take into account management's estimates of future cash flows or that use a discount rate that is specified in a way that does not correspond to one of the identified measurement bases;

(b) initial measurement vs subsequent measurement of assets and liabilities: one ASAF member suggested that measurement bases used for subsequent measurement could be divided into those that are determined wholly or partly by the original measurement and those that are completely independent of the original measurement. Initial measurement is normally relatively straightforward while subsequent measurement is more challenging and normally involves more adjustments; and

(c) cost constraint: some ASAF members questioned whether it is necessary to explicitly mention the cost constraint in the measurement section of the *Conceptual Framework*.

24. In addition, in the course of the discussion one ASAF member asked about the assessment of how an asset or a liability contributes to future cash flows. That ASAF member asked whether this assessment should reflect only circumstances that exist currently, or whether it would also take into account possible future changes in the nature of business activities being conducted.

Implications of long-term investment for the *Conceptual Framework*

25. The IASB staff presented a paper on the implications of long-term investment for the *Conceptual Framework*. The IASB had discussed this paper at the September IASB meeting and had tentatively concluded that, when updated, the *Conceptual Framework* would provide sufficient tools for the IASB to be able to:

(a) make appropriate standard-setting decisions if future projects were to consider how to measure the long-term investments (or liabilities) of entities whose business activities include long-term investment and where to present changes in the carrying amount of those investments (or liabilities); and

(b) address appropriately the needs of long-term investors in a reporting entity.

26. ASAF members supported the IASB's tentative conclusions and made the following comments:

(a) the *Conceptual Framework* cannot focus specifically on the needs of long-term investors because its focus is on general purpose financial reporting;

(b) standard-setters seek to achieve high quality financial reporting standards through their due process and through extensive consultation with constituents. Different needs of different user groups could be discussed in the course of such consultations;

(c) it may be that long-term investors focus more than other investors do on information about long-term cash flows or stewardship. However, in general their information needs should not differ significantly from those of the currently identified primary user groups—existing and potential investors, lenders and other creditors; and

(d) if the *Conceptual Framework* could appropriately articulate how to select the measurement basis of an asset and a liability from the viewpoint of reporting an entity's financial performance, it would effectively address the concern from stakeholders with regard to long-term investment.

Disclosure Initiative

Principles of Disclosure Project

27. The IASB staff introduced the topic of the purpose of the notes to the financial statements. ASAF members were provided with:

(a) an overview of the EFRAG paper *Towards a disclosure framework for the notes*; and

(b) an update on the FASB Disclosure Framework project, specifically in regard to the purpose and boundaries of the notes.

24. ASAF members expressed mixed views regarding the need to have different purposes for the notes to the financial statements and for the primary financial statements. Some ASAF members supported the view that before looking at the purpose of primary financial statements it is necessary to look at the purpose of financial reporting as a whole.

25. The views expressed by ASAF members include:

(a) the IASB could provide a summary of what should go in the financial statements, to avoid duplication with regulators' requirements regarding other documents in financial reporting; however some duplication may be unavoidable.

(b) support for the FASB's view that the Notes are supplementary (ie they are like footnotes) to the primary financial statements.

(c) information in the financial statements should relate to financial accounting, ie past events, measurements and recognitions about the current assets and liabilities of the company.

(d) the financial report should be considered as a whole and that forward-looking information that does not relate to measurements should be considered to be outside the financial statements.

(e) the usefulness of information should be considered as a whole and no difference in importance should be given to either the primary financial statements or the notes.

(f) the notes are merely extensions of the primary financial statements. It was suggested not to have 'primary financial statements' as a term and use only 'financial statements'.

(g) the notes and the primary financial statements should have different purposes, because the primary financial statements show summarised and prominent information.

Consequently, decisions should be made about what goes into the primary financial statements and what goes into the notes.

Amendments to IAS 1

28. The IASB staff provided a brief introduction, noting that the feedback received on the Exposure Draft was generally positive. The IASB asked for ASAF members' views on the ordering of the notes to the financial statements. The IASB was asking for this because responses from investors had been mixed as to whether any order should be specified at all.

29. Some ASAF members were of the view that comparability should take precedence over flexibility. These members were concerned that flexibility makes it difficult for users to locate information and compare information between reporting periods and/or between entities.

30. Other ASAF members were of the view that flexibility offers preparers scope to give prominence to important information and provides preparers with the ability to better 'tell their story'.

31. A number of ASAF members suggested the use of cross-referencing within the notes to enhance their understandability and added that encouraging the use of indexing or of a table of contents would be helpful to the users.

32. One member explicitly mentioned that wider use of XBRL would make comparisons and location of information easier, regardless of its exact positioning or ordering within the financial statements.

IFRS Taxonomy

33. The staff updated the ASAF members on the work undertaken by the IFRS Taxonomy project and the next steps planned.

34. One member stressed the importance of timeliness in updating the taxonomy for software developers.

35. The ASAF members discussed the optimal timing for updating the taxonomy for common practice and expressed mixed views.

Materiality

36. ASAF members discussed the focus of the IASB's work on the application of materiality. The discussion was preceded by a presentation that outlined the research carried out by the IASB staff and the possible approaches that the IASB may take to address the issues identified.

37. The discussion focused on the future steps that the IASB might take. The following is a summary of the main comments made by ASAF members:

(a) Some ASAF members expressed support for the IASB addressing materiality and for the production of education material. However, some ASAF members commented that they did not think that the disclosure problem could be fully addressed by providing guidance on applying materiality and that the IASB should also look at the way in which the disclosure requirements are written. For example, some ASAF members noted that the disclosure requirements should be less rigid ('shall' disclose), and should instead contain more precise disclosure objectives together with the types of disclosure requirements that the entity should consider. This would enable preparers to decide whether the suggested disclosures are relevant to them.

(b) Some ASAF members noted that the concept of 'clearly trivial' was important. These ASAF members noted that if an entity does not comply with requirement in a Standard, it needs to decide whether non-compliance is clearly trivial. Unless something is clearly trivial, the entity's non-compliance would still need to be aggregated as part of misstatements, so that it can be documented and communicated to the audit committee, even if the matter is not deemed to be material.

(c) Some ASAF members suggested that it might be more effective for the IASB to focus on the use of relevance rather than materiality, because it is closer to the terminology used for auditing. It was felt that this would go further towards bridging the gap between how the materiality concept is used in accounting and how it is used in auditing.

(d) Some ASAF members highlighted behavioural issues as being practical constraints on the application of the concept of materiality. These constraints included: extra auditing costs that could arise if information is left out of the financial statement, but that information may be needed for other purposes and subject to audit, eg other filings; risk aversion by practitioners (ie the fear factor); and the fact that it may be more costly to continually monitor information in case it becomes material than it would be to simply disclose that information each year.

(e) Some ASAF members noted that it might be useful to change the focus of the definition of materiality from its current negative emphasis, ie information is material if omitting it or misstating it could influence decisions that users make, to a positive emphasis by which the focus is on what to include rather than omit.

(f) One ASAF member also noted that use of the term 'could influence decisions' in the definition of materiality has led preparers to apply the definition too widely, because almost anything could influence a user. This member thought the focus should be 'is it likely to'.

(g) There was also some discussion about the reality that in practice, many practitioners focus too much on the quantitative aspect of materiality and use quantitative thresholds to help them apply the concept.

Accounting policy disclosures

38. The IASB staff introduced a presentation on accounting policy disclosures and sought input from ASAF members on what makes an accounting policy significant and how improvements regarding accounting policy disclosures should be considered.

39. There were various suggestions from ASAF members, including:

    (a) Accounting policies should be disclosed if there is an element of management input to an entity's selection and application, ie if there is a choice in accounting policy, if the accounting policy changes or if there is significant judgement needed by management when applying it.

    (b) Not every entity should disclose the standard accounting policies, ie accounting policies that do not offer a choice, those that have not changed and those that do not involve significant judgement.

    (c) Only those accounting policies that are relevant to understanding the key aspects of the entity's financial statements should be disclosed.

    (d) The IASB could publish on its website a model set of accounting policies for its Standards. However, one ASAF member suggested that the primary audience of financial statements is sophisticated investors. If investors do not know the accounting requirements then they should instead refer to the IFRS Bound Volumes and that an expectation that users have a knowledge of IFRS is the key reason for jurisdictions adopting IFRS rather than persisting with their own (lesser-known) domestic GAAP.

40. Some ASAF members supported a discussion on accounting policy disclosures being included in the *Principles of Disclosure* Discussion Paper. One of the reasons given by IASB staff for recommending such an approach was that practice regarding disclosing accounting policies is evolving. However, it was suggested by one ASAF member that practice regarding disclosing accounting policies is not evolving in every jurisdiction.

Insurance Contracts

43. The IASB staff sought input on two issues: accounting for contracts with participating features and transition.

Contracts with participating features

44. The IASB staff provided a summary of the IASB's recent discussions on insurance contracts with participating features. The IASB's approach for contracts with participating features is to consider what adaptations are needed to its tentative decisions to date for contracts with no participating features. The IASB was particularly seeking input on the scope of any adaptations to the general model that are needed to reflect the presence of participating

features. The IASB was also seeking input on the book yield and effective yield approaches for determining amounts to recognise in profit or loss and other comprehensive income.

45. Some ASAF members noted that there is a diverse range of products with participating features across different regions and asked whether the IASB had considered how the accounting would apply to these different products. In particular, the staff and ASAF members noted that underlying items would often be wider than sharing the performance of investments in assets, but would also include sharing in mortality, underwriting and expense gains and losses.

Scope

46. ASAF members sought clarification on the proposed scope of any adaptations to the general model. Some ASAF members believed that there needed to be additional guidance on the meaning of the "substantial proportion of risk and return" criterion, and on whether the "minimum amount retained by an insurer" should be assessed on the basis of each reporting period or over the whole contract term. Some ASAF members questioned the justification for the criterion that there should be a "minimum amount retained by the insurer", and one ASAF member observed that in his jurisdiction, many contracts would not meet this criterion.

Regarding the shareholders' share of underlying items as an implicit fee

47. ASAF members had differing views on the notion that the shareholders' share of underlying items should be viewed as an implicit fee, and thus adjust the contractual service margin (CSM). Some members agreed that the shareholders' share of underlying items could be considered as variable consideration for the services provided. However, others did not agree and one ASAF member asked why the gains and losses on the assets and liabilities should not be recognised as they arise. The ASAF noted that a critical question was whether the insurer was acting as an agent for the policyholder in managing the assets, or whether the insurer controlled the assets, and therefore acted as a principal. Most ASAF members agreed that, in most cases, insurers should be viewed as controlling the assets and so should recognise the assets as well as the contractual liabilities. One ASAF member commented that a book yield approach would be justified only when the insurer was acting as an agent.

Release pattern of CSM

48. Some ASAF members noted that the IASB had yet to consider the release pattern for the CSM for participating contracts. That release pattern would depend on the main drivers of profit from services that insurers provide to policyholders. One ASAF member noted that for contracts with participating features, the main service provided would be investment performance, and that the CSM should therefore be released according to the investment performance in the period. That ASAF member also noted that the drivers of release to profit

or loss should differ from portfolio to portfolio because the service varies among different contracts.

Book yield and effective yield approaches

49. The ASAF considered the book yield and effective yield approaches to determining the amounts recognised in profit or loss and other comprehensive income. The ASAF noted that these approaches do not affect the measurement of the insurance contract. Some ASAF members supported the book yield approach because they believe it eliminates accounting mismatches, allowing a better reflection of the asset-liability management. One ASAF member noted that the staff viewed the book yield method as more complex than the effective yield, but it was not clear whether this was the case.

50. IASB staff flagged that consideration might be given to some variations of the book yield and effective yield methods in an attempt to avoid the drawbacks of each method individually.

Transition

51. Most ASAF members agreed that entities should apply the Standard retrospectively at the date of transition. Some ASAF members noted that retrospective application in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* would usually be impracticable. Consequently, ASAF members agreed that there should be simplifications for cases in which retrospective approach would not be practicable.

52. ASAF members also discussed whether there was a need to address situations in which entities lack data for both retrospective application and even lacked the necessary data to apply the proposed simplifications. There were mixed views about what the Standard should require in such cases:

    (a) Some ASAF members would calibrate the CSM to the fair value measurement of the insurance liability at the date of transition. However, one ASAF member noted that fair value may be difficult to calculate and audit.

    (b) Most ASAF members agreed that the CSM should not be zero. However, there was one exception, as described in paragraph 53.

53. Some ASAF members believe that entities should be able to use any simplifications that achieve the objective of retrospective application. They believe that allowing an entity to develop its own simplifications to perform retrospective application would widen the range of the contracts that could approximate retrospective application. With that in mind, one ASAF member believed that it would be acceptable to set the CSM to zero for contracts for which all such simplifications would be impracticable.

54. In addition, one ASAF member noted that, in his jurisdiction, many were familiar with existing measures of the insurance contract (such as embedded value). He observed that there could

be benefit in developing a special transitional arrangement (such as the use of fair value in measuring insurance contract liabilities) to bridge the measurement that would result from retrospective application of the new Standard and these existing measures.

Financial Instruments with Characteristics of Equity research project

55. The IASB staff presented the ASAF with a paper outlining two broad alternatives that the IASB could consider in proceeding with the project:

    (a) a fundamental review of *IAS 32 Financial Instruments: Presentation*; or

    (b) maintenance of IAS 32, but with improvements to its presentation and disclosure requirements.

56. Many ASAF members stated that while a fundamental review of the requirements was necessary, the IASB should not necessarily start from an entirely blank sheet of paper. IAS 32 had proved to be robust during the financial crisis, although new financial products, such as bonds that are contingently convertible into equity if a non-viability event occurs, were testing the requirements. A fundamental review is needed to provide a better foundation and should focus on identifying the objectives of the distinction between liabilities and equity.

57. Some ASAF members cautioned the IASB against pursuing a narrow-scope project, because of the risk of introducing further exceptions and inconsistencies.

58. Some ASAF members stated that it is important that the IASB should consider the distinction between liabilities and equity from the perspectives of both financial position and financial performance.

59. One ASAF member asked for more clarity about the plan to revisit the *Conceptual Framework* definitions after performing the research. Another ASAF member stated that the decision to consider the distinction between liabilities and equity further in the research project was not consistent with the decision to expose the tentative definitions in the Exposure Draft. Yet another ASAF member thought that the *Conceptual Framework* project should take the lead and not follow the research project.

Project Update and Agenda Planning

60. The IASB staff noted that the papers provided to ASAF members included an overview of the status of current projects and a proposed agenda for the December 2014 meeting. ASAF members were asked if they had any comments on proposed agenda. One ASAF member suggested that the Leases project should also be included in the agenda. It was noted that the inflation accounting topic originally scheduled for this meeting is being deferred to the December meeting.

61. Because there were no further comments the meeting was concluded. Hans Hoogervorst noted that it had been a good meeting and the IASB had received some very valuable input on the topics discussed.