

## Report of the Due Process Oversight Committee (DPOC) meeting

Frankfurt, 16 October 2013

### 1. Update on technical activities

1.1 The DPOC received an update on technical activities.

#### *Major projects*

1.2 The DPOC was updated on the progress of the major projects on the IASB's work plan. On **financial instruments: hedge accounting**, the DPOC was reminded that it had conducted a lifecycle review of the project at its April 2013 meeting. The IASB was now in the process of balloting the hedge accounting chapter for inclusion in IFRS 9 *Financial Instruments*. The DPOC was informed that, as well as the revised hedge accounting requirements, the document would also include two further changes. The first was the removal of the mandatory effective date of IFRS 9 (currently 2015); and the second was an amendment related to the presentation of changes in the value of own credit risk on financial liabilities. It was noted that the revisions were expected to be well-received by constituents.

1.3 On **financial instruments: classification and measurement**, the main changes proposed in the recent Exposure Draft (ED) were to clarify the notion of principal and interest, to introduce a fair value through Other Comprehensive Income (OCI) category for simple debt investments, and to propose the clarification to the concept of 'holding to collect' contractual cash flows. Joint deliberations by the IASB and the US Financial Accounting Standards Board (FASB) had started in September 2013, with discussion of the features of debt instruments with simple features ('solely principal and interest') that would be eligible for measurement other than at fair value through profit or loss. It was noted that the two Boards were at different stages of development (with the IASB looking only at limited amendments to IFRS 9), but it was hoped the outcome would bring the requirements in IFRSs and US GAAP closer together. The DPOC noted that its next step would be to undertake a 'lifecycle' review of the project, but that the timing had slowed down somewhat, with the changes expected to be finalised in the first half of 2014.

1.4 On **financial instruments: impairment**, the DPOC was reminded that this was one of the most critical and difficult parts of the IASB's project to overhaul the accounting for financial instruments. The IASB's ED *Financial Instruments: Expected Credit Losses* had been well received, with strong support from users of financial statements, preparers and audit firms. The IASB was continuing to work hard, including undertaking extensive fieldwork, to make its proposals operational. The prospect of convergence with the US, however, was unlikely. The FASB's view of its proposals for expected credit losses was that US investors and US prudential regulators preferred the FASB approach that recognised upfront all expected credit losses (although some did not agree that all losses be recognised in profit or loss on 'day 1'). The upshot was that both the IASB and FASB have support from their respective constituents for their respective models. That made even more challenging the achievement of a converged solution that was being pushed for by the G20, the Financial Stability Board (FSB) and some major banks. The DPOC sought clarification on the views of prudential regulators in particular and that the IASB would continue to discuss with the FASB what scope there might be to move their respective models closer, but the IASB representatives were not

optimistic that a converged solution would be reached. From a due process perspective, the IASB was confident that it had taken all necessary steps and had sufficient information and feedback to move forward.

1.5 On **accounting for macro hedging**, the DPOC noted that, at its October meeting, the IASB would receive a paper setting out the due process steps taken in developing a Discussion Paper (DP) and seeking the IASB's permission to ballot the DP, which it was expected would be published later in 2013 or early in 2014.

1.6 With regard to the other major projects, the DPOC noted that the comment period on the second ED on **leases** had closed on 13 September 2013. During the comment period extensive outreach activities had been undertaken focussing in particular on obtaining feedback from users of financial statements (with meetings involving over 220 investors and analysts), which had revealed support from the majority of users for the proposal to recognise lease assets or liabilities on the balance sheet. The outreach had shown that investors already made their own adjustments to reflect the lack of recognition and that they often over-estimated the extent of leverage in the balance sheet. Extensive work had also been undertaken on understanding the drivers of costs for preparers, which had revealed that the proposals would be costly to implement, but were achievable. The view from the IASB was that the IASB and the FASB needed to stand strong in the face of significant resistance if the proposals were to be finalised. The DPOC noted that concerns had been raised in some quarters in the US that the IASB at least had taken firm positions and would not listen to arguments from those who held different views. It was noted that the redeliberations on the comments received both in comment letters and other outreach had yet to recommence. The DPOC also heard that views had been raised by some constituents that, while in principle recognising leases on the balance sheet was the right approach, it was the wrong time in the cycle to push this through. On this issue, the DPOC was informed that the standard would have an implementation period of possibly 3-4 years, so that they would come into effect in a different stage of the cycle. Finally, the DPOC was informed that the IASB was planning to put together an extensive effects analysis to accompany the final IFRS.

1.7 On **revenue recognition**, the DPOC was reminded that it had conducted a lifecycle review of the project at its July 2013 meeting. However, as part of the 'fatal flaw' process in considering a draft of the proposed standard for editorial review, three issues had been raised (on collectability, constraint, and licences) that had been discussed by the IASB and FASB in September. The intention was to finalise the discussions in October and then (hopefully) move to the final Standard.

1.8 On **insurance contracts**, the IASB had issued a revised ED in late June 2013 and the comment period was about to come to an end. The IASB had undertaken extensive outreach. The DPOC noted that the views of the industry on the proposals were diverse. In seeking to deal with concerns on volatility expressed in regard to the proposals in the 2010 ED, the trade-off of the proposals in the revised ED had been an increase in complexity. The DPOC was informed that a number of major insurance companies had carried out extensive fieldwork on the proposals, which had revealed some significant concerns with regards to volatility and accounting mismatches. The DPOC expressed a view that comments raised such as these needed to receive due consideration. The IASB confirmed that it was committed to finding an acceptable solution and was working hard to listen to and communicate with the industry.

1.9 On the **conceptual framework** project, a DP had been issued during July, with a 180 day comment period. The IASB was carrying out extensive outreach, including holding a number of public roundtables.

1.10 On **rate-regulated activities**, it was noted that in September 2013 the IASB had received an initial summary of the responses received to the proposals for an interim IFRS. The IASB was scheduled to begin redeliberations on the proposals at its meeting in October 2013.

1.11 In the case of all the major projects discussed, the DPOC was satisfied that all the due process requirements as set out in the *Due Process Handbook* were being met.

#### *Implementation and maintenance projects*

1.12 The DPOC was updated on the progress of a number of the implementation and maintenance projects on the IASB's work plan. On **IAS 1 disclosure initiative** the DPOC was informed that the IASB had, at its September 2013 meeting, considered narrow scope amendments to the Standard that were intended to clarify existing requirements. The IASB was also continuing to examine disclosure requirements about the assessment of **going concern**. The IASB planned to issue an ED on this and other amendments to IAS 1 arising from the follow-up to the IASB's Disclosure Forum in the first quarter of 2014.

1.11 The DPOC was informed that the IASB was continuing preparatory work for the **Post-Implementation Review (PIR) of IFRS 3 Business Combinations**. The PIR was in its first phase with outreach being undertaken to identify implementation problems or unexpected costs that had arisen in the application of IFRS 3, together with academic or other studies about the Standard. The DPOC was reminded that there was no presumption that a PIR would lead to any changes in a Standard.

## **2. Educational Material**

2.1 The DPOC considered a report setting out some initial thoughts in relation to the preparation and issue of educational material developed by the IASB. It was noted that the development of educational material was important, but was a risk area for the IASB, because support material prepared after a Standard could be seen as interpretative and change IFRS requirements. The DPOC was reminded that, in the light of the educational material prepared, but not issued, in relation to IFRS 11 *Joint Arrangements*, the IASB was continuing to take a cautious approach and not to issue material that could be confused with an IFRS or perceived as being mandatory or interpretative in nature.

2.2 The staff of the IASB noted that there were three main issues that needed to be considered:

- a. the purpose and nature of the material that was issued as part of a Standard (such as Application Guidance) and the purpose and nature of material that accompanied, but was not part of, the Standard (such as Illustrative Examples) needed to be clarified;
- b. the descriptions and 'packaging' of support material did not provide sufficient delineation between mandatory and support material; and

- c. there was a lack of clarity in the minds of some about how the IASB responded, or should respond, to post-issuance requests for help. As well as the IFRS 11 experience, the issue had been brought into focus by the announcement in July by the IASB and FASB to create an implementation group focused on the upcoming final converged standard on revenue recognition.

2.3 The DPOC was informed that the IFRS Advisory Council had discussed the issue at its October meeting, where a range of views had been expressed, although there was general support for what the IASB did. The ideal model was that the IASB should develop a Standard with an appropriate level of implementation support. If there was a need for educational material, then there was a need to make sure that it was clearly differentiated from mandatory material (although a number of Advisory Council members expressed the view that any material produced by the IASB – whether labelled as mandatory or educational – was authoritative).

2.4 The Advisory Council had acknowledged the difficulty of what to do in the post-issuance period after a Standard was published, cautioning against the creation of an implementation group for every Standard, which ran the risk of over-engineering. There was a need to take a flexible approach. The DPOC acknowledged this, noting the clear view that the implementation group would not issue guidance. If it identified issues, these would be referred to the Boards and their respective interpretations bodies. There had been precedents for such post-issuance support, for example on IFRS 3, where staff had received some 70 requests for amendments to the Standard, where were referred to and considered by the Interpretations Committee, which eventually took forward only three issues.

2.5 The DPOC welcomed the IASB's efforts to further clarify the distinction between material issued as part of a Standard, and therefore subject to the transparency of full due process, and material support that supported, but which was not part of, a Standard and thus subject to less extensive due process. The DPOC was encouraged by these efforts, and expressed a willingness to consider proposals for clarifying amendments to the Due Process Handbook once the IASB had completed its further research and outreach on the topic.

### **3. Effects Analysis Consultative Group**

3.1 The DPOC received a progress report on the work of the Effects Analysis Consultative Group (EACG), which had been set up to advise the IASB in developing an agreed methodology for field testing and effects analyses. The EACG had met twice and was in the process of preparing a report of its recommendations to the IASB. The Advisory Council had considered the EACG's emerging thinking at its October meeting and had given positive feedback that the Group was on the right track.

3.2 The EACG had spent a good deal of time considering what was the purpose of an effects analysis, noting that while existing and potential investors, lenders and other creditors were the primary users, IFRS financial information was used by other parties, such as prudential regulators and taxation authorities. The EACG had noted the view of some commentators that the IASB should consider financial stability when setting financial reporting requirements. In drafting its report, the EACG was seeking to reconcile these views. The EACG's emerging view was that the primary purpose of an effects analysis was to assess the likely effects of proposed new financial reporting requirement in the light of the objective of financial reporting as set out in the *Conceptual*

*Framework*. That said, the EACG's view was that there was a need to acknowledge that the IASB did not operate in a vacuum and that financial stability was important. On this issue, the DPOC cautioned that the IASB's legitimate efforts to be sensitive to the user needs of prudential regulators should not inadvertently expand the scope of the analysis beyond the constitutional limits of its standard setting responsibilities and should be consistent with the objectives of financial reporting as set out in the *Conceptual Framework*. The IASB needed to bear in mind the importance of helping other parties to assess the consequences of its proposals.

3.3 The DPOC also noted that the EACG was tackling the issue of transparency, in particular in relation to fieldwork. The IASB conducted a lot of fieldwork on its projects, but was not always able to make the names of participants or the detailed work available for others to review, as those who participated would only do so under conditions of confidentiality. For example, the IASB had recently undertaken work with a group of banks and corporates to assess the likely effects of the proposed credit impairment model on loan loss provisions. Some of the participating organisations had spent over 500 hours on this work, with one devoting over 600 hours, but all on a confidential basis, not least given the fact that the detailed calculations and assessments could include price-sensitive information. Without the assurance of confidentiality, the IASB would not have been able to conduct this fieldwork. But confidentiality did raise issues of transparency, which was a general theme that had been raised in the consultation on the revisions to the Due Process Handbook and was a theme raised in correspondence by third parties (see section 6 below). The staff were continuing efforts to improve the transparency of such reporting while respecting requests for confidentiality.

3.4 The DPOC also noted that the EACG was looking at the communications aspects of effects analysis. An assessment of the likely effects would be reflected throughout the development of an IFRS, but to make it more transparent, one of the likely recommendations of the EACG report would be for the IASB to publish a separate effects analysis report at the same time as an IFRS was published. An assessment of the effects would remain within the Basis for Conclusions, but the need for a separate report reflected the fact that the main audience interested in assessing the effects for regulatory purposes was different to that for the Basis.

3.5 The DPOC was informed that the EACG was next meeting in November 2013 to discuss its draft report and how its members would express their views.

#### **4. Consultative groups: Update**

4.1 The DPOC considered an update on a number of consultative groups following the annual review that had been considered by the Committee at its July 2013 meeting:

- **Accounting Standards Advisory Forum (ASAF)** – this group was at present very active, not least given its role as the consultative group on the conceptual framework project. The second full meeting of the group had taken place on 25-26 September, at which discussions had been held, not only on the conceptual framework, but also on disclosure, insurance contracts, leases, accounting for macro-hedging and impairment. The next meeting would take place on 5-6 December, with a full-day scheduled on the conceptual framework. The DPOC again noted that ASAF members themselves were preparing papers for discussion by the group (including possible papers from the Australian Accounting Standards Board on liabilities and the Accounting Standards Board of Japan on measurement);

- **Capital Markets Advisory Committee (CMAC)** – the DPOC was informed that a call for new members of CMAC had been made and that the staff would come back to the DPOC via e-mail with proposals for membership for the Committee to review the proposed composition to ensure that there was a satisfactory balance of perspectives;
- **Education and Advisory Group (EAG)** – the DPOC noted that a new member (Li Kouqing, from the Shanghai National Accounting Institute) had joined this group, and was reminded that future appointments to the EAG would only be made after a public call for applications, in line with the decision of the Trustees’ Education and Content Services Committee, at its April 2013 meeting;
- **Shariah-compliant Instruments and Transactions** – the DPOC was updated on the progress of this group. The DPOC also considered and was content with proposals to expand the membership of this group, noting that the potential new candidates had yet to be contacted (and hence not identified in this report). Given that this was an area where the IASB relied heavily on the expertise of others, the membership and work of the group would be kept under review.

4.2 The DPOC enquired again about the effectiveness of those groups where formal meetings had not been held in the past year. The DPOC continued to be satisfied with the explanation that most project work groups had the bulk of their meetings at the beginning of a project’s life as the initial ED was being contemplated. As the project advanced toward its final stages, the role of the working group evolved to that of a list of experts that the IASB could call on to get specific advice on specific elements of the proposed standard. This stage did not usually require formal meetings of the group. Despite the fact that they were no longer meeting as a group, the IASB needed to keep the individuals on these groups active in the process until the project was complete. After questioning from Committee members, who were mindful of the need not to impose too much due process, the IASB agreed to promptly come back with proposals to disband any groups that had outlived their original purpose.

#### *DPOC engagement*

4.3 On engagement, the DPOC noted that the Director for Trustee Activities had observed the meetings of the EACG and the Rate-regulated Activities Consultative Group (RRACG) held in July 2013 and had reported positively on the level of attendance and the quality of participation and debate at both of them. The Chairman of the DPOC reported that he and a number of other DPOC members had attended the first day of the October 2013 meeting of the IFRS Advisory Council. He reported that, after a slow start, the level of participation and debate at the Advisory Council meeting had been good, and the meeting had been chaired well. The Chairman noted that the Advisory Council had recently undertaken a performance self-assessment and, at its meeting, had considered a number of areas that it might explore further. The assessment and its follow-up would provide a good basis for the DPOC to dialogue with the Advisory Council. The Chairman noted that the Advisory Council very much appreciated attendance by Trustees, in particular in their break-out sessions, and encouraged DPOC members to attend if their schedules allowed.

4.4 The Chairman again reminded the DPOC that it had a responsibility to monitor the effectiveness of the bodies and consultative groups that supported the IASB and that a member of the DPOC (or the Director for Trustee Activities on behalf of the DPOC) should observe at least part

of a face-to-face meeting of each of the major groups once a year and report back to the Committee to validate the breadth of attendance and an appreciation of the quality of dialogue. The DPOC should be more proactive and have dialogues with the groups, which would also have the benefit of helping to address any potential problems with their operations. He noted that a DPOC member was scheduled to attend the November 2013 meeting of the Global Preparers' Forum (GPF) and invited DPOC members to submit further attendance suggestions by e-mail.

## **5. XBRL (electronic reporting)**

5.1 The DPOC considered a report progress report on the IASB's previously approved plan to restructure staffing and consultative activities related to electronic reporting, covering three issues in particular:

- the proposed update to the IFRS Taxonomy;
- a review of the due process for XBRL; and
- proposals to replace the XBRL Advisory Council (XAC) and XBRL Quality Review Team (XQRT).

5.2 The DPOC was also informed of recent developments, notably the announcement on 10 October of the formation of a new staff group to work on the IASB's Disclosure Initiative, bringing together members of the IASB's standard-setting team with the XBRL team. The creation of a combined team of standard-setting and electronic reporting experts reflected the increasing importance of electronic filing of financial information. The integration of the XBRL team into the IASB's work programme also completed a major aspect of the recent strategic review of XBRL.

5.3 On the update to the Taxonomy, the DPOC was reminded that, at its July 2013 meeting, it had agreed in principle to a request from the IASB to apply a modified due process for the preparation of the IFRS Taxonomy. As a first step, the Foundation had issued an ED of a Proposed Interim Release *IFRS Taxonomy 2013* in September 2013, in line with the proposal that the interim release should be the main focus for public consultation, rather than the year-end 'compilation' as in the past (which normally generated only a small number of comment letters). The comment deadline on the release was 11 November. The DPOC was informed that, on 24 September, the US Securities and Exchange Commission (SEC) had referred to the Interim Release and encouraged all interested parties to participate in the public review, which the Foundation viewed as a positive step.

5.4 On due process, the IASB was proposing a modified approach under which only the changes from the 2013 Taxonomy to the 2014 one would be exposed for comment, rather than the full Taxonomy (which would align with how the IASB exposes proposed changes to its Standards and Interpretations). This would allow the 2014 Taxonomy to be available earlier. The IASB was planning to provide the DPOC with an assessment on the general revision to the XBRL due process by the end of 2013, with a proposal as follows:

- interim taxonomies would be issued for all Taxonomy changes including, but not limited to, architectural changes, new or amended IFRSs issued and changes to reflect common practice;
- the Taxonomy would be available for use as close to the availability of the Standards that it captured; and

- all interim releases with proposed updates would be exposed for public comment.

5.5 The DPOC was informed that one of the longer term goals was to have the IASB (ie the Board) more closely involved with the development and approval of the Taxonomy. But a note of caution was struck in noting that the Board had yet to be involved in the development of a Taxonomy and there was a need to undertake education work with the Board to establish what decisions it should be involved with. The issue was raised, but not answered, as to who would approve the Taxonomy if the Board did not do so.

5.6 The DPOC was updated on the progress of the proposal to replace the XAC and XQRT with one consultative group, the IFRS Taxonomy Advisory and Review Committee (ITARC). It was envisaged that the ITARC would provide technical advice and specific strategic implementation advice related to the Taxonomy, with the Advisory Council providing strategic oversight and steering guidance. The DPOC expressed concern that the restructuring could lead to the loss of useful expertise, in particular with the demise of the XAC, but received reassurance that the restructuring might actually help in the retention of members with relevant skills and expertise.

5.7 The DPOC took note of the progress overall and that the staff plan was to bring forward to its January 2014 meeting a formal proposal for the development of the IFRS Taxonomy.

## **6. Correspondence**

6.1 The DPOC discussed a complaint that it received from Business Europe regarding the accuracy of staff reporting on comment letters, in relation to a proposal to amend IAS 40 *Investment Property* as part of the project on the 2011-13 Annual Improvements cycle. The DPOC was informed that the issue had been presented to the IASB at its September 2013 meeting and that the staff had discussed the complaint with representatives of Business Europe. In addition, an in-house session had been held with IASB technical staff on preparing a comment letter analysis. The Committee was satisfied that staff had responded in a timely and comprehensive manner to the complaint, and approved a response letter from the DPOC to Business Europe regarding the matter.

6.2 The Business Europe correspondence also highlighted the general handling of feedback from outreach activities, on which the IASB reported that it had enhanced staff training. The staff would keep the DPOC informed on its continuing efforts to improve the transparency of reporting of feedback from outreach and fieldwork activities, particularly with respect to reporting on feedback from persons and/or organisations who wished to remain anonymous.

6.3 Other than the Business Europe letter, no new correspondence cases had been submitted since the July 2013 meeting.

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