Summary note of the Accounting Standards Advisory Forum

Held on 16 and 17 July 2015 at the IASB office, 30 Cannon Street, London

This note is prepared by staff of the International Accounting Standards Board (IASB), and is a high-level summary of the discussion that took place with the Accounting Standards Advisory Forum (ASAF). A full recording of the meeting is available on the IASB website.

ASAF members attending

Andreas Barckow	Accounting Standards Committee of Germany
Alexsandro Broedel Lopes	Group of Latin American Standard-Setters
Kim Bromfield	South African Financial Reporting Standards Council
Patrick de Cambourg	Autorité des normes comptables
Clement Chan	Asian-Oceanian Standard-Setters Group
Françoise Flores	European Financial Reporting Advisory Group
Alberto Giussani	Organismo Italiano di Contabilitả
Russell Golden	Financial Accounting Standards Board
Lu Jianqiao	China Accounting Standards Committee
Linda Mezon	Accounting Standards Board of Canada
Yukio Ono	Accounting Standards Board of Japan
Kris Peach	Australian Accounting Standards Board and the New Zealand Accounting Standards Board

Insurance contracts

1. ASAF members discussed three topics related to the IASB's Insurance Contracts project:

    (a) an AASB and NZASB paper on the recognition pattern for the contractual service margin (CSM) in profit or loss;

    (b) an AASB and NZASB paper on the rate used for interest accretion on the CSM and the disclosure related to impacts of the discount rate; and

    (c) an update on the IASB's tentative decisions since the last ASAF meeting, including the papers to be discussed with the IASB at the July meeting.

Recognition of CSM for insurance contracts

2. Angus Thomson presented a recommendation from the AASB and the NZASB that when the expected pattern of release for the CSM differs significantly from the passage of time, the CSM should be recognised in profit or loss on the basis of the expected timing of incurred claims and benefits. The AASB and NZASB consider that, for some types of insurance

contracts, the value of the stand-ready service to the policyholder varies over the contract period and noted that the risk adjustment is determined from the insurer's viewpoint and may not capture all the elements that can be expected to vary over the life of a contract. One specific example of such a case, presented in the paper, is lender mortgage insurance, which usually has higher claims, higher capital demands and higher levels of service in the early years as compared to the later years.

3. In contrast to the AASB's and the NZASB's recommendation, the IASB has tentatively decided that the CSM should be recognised in profit or loss based on the passage of time.

4. One ASAF member supported this recommendation, noting a similar case to lender mortgage insurance in their country, in which the passage of time is not a suitable measure for the recognition of the CSM. This member suggested that a pattern based on the passage of time should be a rebuttable presumption, but other methods should be permitted if they reflect the contract's economics in a better way. In addition, another member thought that such an approach might be consistent with other Standards, including IFRS 15 *Revenue from Contracts with Customers*.

5. In contrast, most ASAF members supported the IASB's tentative decision, because:

   (a) even though many insurers liked the idea of using methods other than the passage of time to recognise the CSM, they also agreed that the passage of time method was the most practical method and the easiest to implement;

   (b) the service provided in the contract is related to a stand-ready obligation, which some regard as a constant over time;

   (c) for life products, the benefits are expected at the end of the contract and they did not believe that recognising the CSM using the pattern of claims and benefits would be suitable, because the CSM would be released only towards the end of the contract; and

   (d) the CSM could be seen as a residual amount and therefore the pattern based on the passage of time would be appropriate.

6. One ASAF member noted that, while he generally supports the IASB's tentative decision regarding how to account for the CSM in subsequent periods, it would be helpful to clarity what the principle is and what the method is to achieve the principle. In his view, the principle would be that the CSM should continue to represent unearned profit of insurance contracts throughout the coverage period, and amortisation based on passage of time would be the method to support the principle.

7. The IASB staff explained that some constituents believe that the CSM release should follow a similar pattern to the release of risk. The IASB staff explained that, in their view, the release of the risk margin to profit or loss already reflects the risk pattern. Consequently, the principle is that the CSM component of the liability represents the stand-ready obligation to

provide insurance coverage and that the stand-ready obligation is satisfied evenly throughout the coverage period.

Rate used for interest accretion and unlocking the CSM and the disclosure related to impacts of the discount rate

8. The IASB has tentatively decided that for insurance contracts without participation features an entity should use a locked-in rate at inception to:

   (a) accrete interest on the CSM; and

   (b) calculate changes in the present value of expected cash flows that are offset against CSM (often referred to as 'unlocking').

9. In addition, the IASB has tentatively decided that an entity should make an accounting policy choice on whether to present the difference between the locked-in rate and the current rate in other comprehensive income (OCI) or profit or loss. To help users compare entities, the IASB has tentatively decided to require the disclosure of the effect of discount rates.

10. Angus Thomson presented the AASB's and the NZASB's proposal for contracts without participating features. That proposal:

    (a) would use a current rate for the measurement of the CSM, including the interest accretion and unlocking. This would make the CSM closer to a current value and would make the measurement of the whole insurance liability more consistent;

    (b) would not require using the discount rate at inception for any disclosures; and

    (c) would not involve requiring a current rate to be used for the measurement of the CSM for entities that have elected the accounting policy choice to recognise changes in discount rates in OCI.

11. Angus Thomson noted the complexity of tracking the locked-in rates at inception.

12. Angus Thomson noted that in response to the questions received after the paper had been posted, the recommendation is to remeasure the CSM using the current rate. That is, the opening balance of the CSM is remeasured at the current rate, in addition to the application of the current rate to accretion and unlocking.

13. ASAF members had differing views on which rate should be used to measure CSM:

    (a) one member agreed with the IASB's tentative decision to use a locked-in rate. This is because the CSM represents the residual amount after inflows and outflows and therefore the entity should not remeasure it.

    (b) one member disagreed that there should be an accounting policy choice and therefore disagreed that the accounting policy choice should be extended.

    (c) one member was in favour of the AASB's and the NZASB's proposal to use the current rate, because it measures the entire liability at the current value, including the CSM.

However, that member would apply it to all contracts. Entities recognising changes in OCI would also need to recognise in OCI the discount rate changes arising from applying the current rate to the CSM. This member believed that such an approach would address the issue of comparability and would eliminate the need for unnecessary disclosures to explain differences in presentation because of accounting policy choices.

(d) one member noted that using a locked-in rate would add an operational burden on preparers, especially if they did not use OCI for presentation purposes. This is because they would not have previously needed to track that rate for any other purpose.

(e) another member noted that in their jurisdiction people are comfortable with the current value and are using the current rate. However, which rate is used should depend on what the CSM represents. If this is a phenomenon that is more consistent with the one captured in IFRS 15 (prepaid revenue), then a locked-in rate should be used, to be consistent.

14. ASAF members noted that it was important to provide comparable information to users, including appropriate disclosures, when there is an accounting policy choice.

Update on the project

15. The IASB staff provided an update on the latest developments in the project, including:

(a) decisions related to contracts with participation features.

(b) the accounting consequences that could arise from the application of IFRS 9 *Financial Instruments* for entities applying IFRS 4 *Insurance Contracts* prior to issuance of the new insurance contracts Standard. The IASB staff explained that they are exploring possible approaches to the concerns highlighted regarding the interaction of IFRS 9 and IFRS 4. The IASB staff explained an approach whereby particular effects of applying IFRS 9 are removed from profit or loss and recognised in OCI until the new insurance contracts Standard is applied. The approach explained could apply to financial assets that were previously, or would have been, classified at amortised cost or as available for sale in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* and are classified at fair value through profit or loss in accordance with IFRS 9.

16. In relation to contracts with participation features, many ASAF members considered that the variable fee approach, as outlined, was a step in the right direction. Some ASAF members noted that their jurisdictions are in the process of determining whether their insurance contracts with participating features will qualify for the variable-fee approach. Other ASAF members noted that the criteria for the variable fee approach would not permit this approach to be applied for some insurance contracts even though some believed that approach should be applied for them. Reasons noted by ASAF members as to why some insurance contracts would not qualify for the variable-fee approach were that (i) those contracts prohibit defining

a share of return or (ii) although insurers are not prohibited from defining a share of return, they are not legally obliged to do so.

17. Members of the IASB noted that the lack of contractual terms may indicate that the contract obligation cannot be represented as the fair value of the underlying items and the entity is earning a ‘fee’ from its share of the underlying items. Both of these are in the essence of the variable-fee approach.

18. One ASAF member noted that constituents in his jurisdiction are in the learning phase of the proposals and stressed the importance of ensuring the operationality of the final Standard, referring to the complexities of the accounting models being discussed. In addition, he stated that there is a question as to whether a public consultation would be necessary, given the extent of changes made to the requirements in the Exposure Draft of 2013.

19. Some ASAF members provided comments on the interaction between IFRS 9 and the new insurance contracts Standard, including:

    (a) the approach outlined is a step in the right direction and addresses the concern about volatility and accounting mismatches in profit or loss in a practical and operational manner.

    (b) one ASAF member raised a concern about the cost to preparers of implementing the proposed approach. It was requested that the IASB should seek to ensure that insurers do not have to implement IFRS 9 twice.

    (c) another member stated that the proposed adjustment to profit or loss may trigger questions from users of financial statements and expressed a view that deferring the effective date of IFRS 9 would not trigger such questions. Members of the IASB noted that the proposed approach would provide users of financial statements with both IFRS 9 and IAS 39 information in a transparent and understandable manner and would ensure comparability. One ASAF member raised concerns about the scope of the proposed approach and noted that banks in that member’s jurisdiction also issued insurance contracts. They question whether any proposed approaches should be applicable to banks.

Discount rates

20. At this ASAF meeting the IASB staff:

    (a) provided a summary of findings from the research project on present value measurements (PVMs)—discount rates and the potential inconsistencies identified;

    (b) sought ASAF members' views on the findings and on whether there is a need for change in each of the five aspects of research discussed: scope of PVMs, impact of PVMs on performance reporting, PVM objectives, components of PVMs and measurement methodology; and

    (c) sought ASAF members' views on the next steps in the project.

21. In discussing the scope of PVMs in IFRS, ASAF members provided the following thoughts:

    (a) the principle of accounting for the time value of money should be emphasised, preferably in the *Conceptual Framework for Financial Reporting*; some ASAF members noted that this did not mean that there was a need to change specific measurements that do not reflect the time value of money at the moment. One ASAF member stated that it would be helpful to research the basic building blocks that underpin time value of money. Discounting of deferred taxes would eliminate some undesirable effects of not discounting, such as recognising a bargain purchase gain when acquiring an entity with significant deferred tax assets. Some noted the statement in IAS 12 *Income Taxes* that discounting deferred tax assets and deferred tax liabilities would require impracticable or highly complex scheduling. However, other ASAF members saw discounting such items as being no more complex than for other measurements with uncertain cash flows. Some wondered whether discounting could be introduced for deferred tax without carrying out a comprehensive overhaul of IAS 12.

    (b) reflecting the time value of money in prepayments is the opposite side of the accounting in IFRS 15 and should be addressed.

    (c) it would be worth considering whether PVMs always provide relevant information in the current low-interest environment, and how to identify discount rates for very long-term periods (such as over 30 years).

22. In discussing the impact of PVMs on performance reporting, ASAF members stated that:

    (a) there are inconsistencies in the impact of discounting on performance reporting but these might be better addressed in other projects.

    (b) the guidance in the *Conceptual Framework* should address when and why some items should be recognised in OCI and not in profit or loss. The guidance in the *Conceptual Framework* Exposure Draft (ED) may not be sufficient.

(c) this aspect of the work should be linked to the research project on primary financial statements (previously called 'Performance Reporting') and to previous work on financial statement presentation.

(d) one member made a comment on the need to separately report the effects of inflation.

23. In discussing the measurement objectives for different PVMs, ASAF members stated that:

(a) a clear measurement objective should be a starting-point for determining how to arrive at a present value, but many Standards do not provide a clear objective. Addressing the lack of a measurement objective in IAS 19 *Employee Benefits* was seen as a priority for some ASAF members.

(b) the concept of value in use is not so complex and should remain but there are concerns about possible manipulation and about whether it is enforceable.

(c) it is not clear what it means to adopt an entity perspective in measurement and different interpretations may arise.

24. In discussing the next steps in the project, ASAF members stated that:

(a) publishing findings of the research would create a good reference point for future Standard-setting activities. The findings could list the areas of inconsistencies identified and summarise the feedback received.

(b) individual issues can then be addressed, starting with measurement basis.

(c) the principles of PVM should be set out in the *Conceptual Framework*.

(d) further steps might include education materials. These can be determined after the publication of a research document.

(e) it is important to consider whether issues identified should be discussed as part of this project or other projects, given that some of the issues are already being considered in other projects (such as the *Conceptual Framework* or *Primary Financial Statements*).

25. ASAF members did not have enough time to discuss the components and methodology for PVMs and will provide any comments outside the meeting.

The *Conceptual Framework*

26. At this meeting ASAF members discussed:

    (a) the recognition and derecognition proposals in the *Conceptual Framework* ED; and

    (b) a paper prepared by EFRAG–*Profit or loss versus OCI*.

Recognition and derecognition

27. The IASB staff described the proposals on recognition and derecognition in the *Conceptual Framework* ED and explained that the purpose of this session was to stimulate debate. The staff acknowledged that final views on the proposals might change from those expressed during the meeting.

Recognition

28. ASAF members were asked whether they agreed with the proposed approach to recognition. The IASB staff noted that the existing recognition criteria, which refer to probability and reliability, have not been applied consistently by the IASB when developing Standards. The recognition criteria proposed in the *Conceptual Framework* ED are an attempt to capture the thought process that the IASB has used in recent years when making decisions about recognition.

29. Some ASAF members stated that the proposed recognition criteria, which refer to the qualitative characteristics of useful information, are too high-level to provide useful guidance to either the IASB or preparers of financial statements. They called for more concrete criteria to be included in the *Conceptual Framework*.

30. Some ASAF members suggested that probability should be retained as a recognition criterion (ie assets and liabilities should only be recognised if the probability of an inflow or outflow of economic benefits exceeds a specified threshold). They stated that difficult cases (such as derivatives) could be treated as an exception. The IASB staff suggested that such an approach would be likely to result in frequent departures from the *Conceptual Framework*, and that it would be undesirable to encourage departures that cannot be explained by material in the *Conceptual Framework*.

31. A few ASAF members expressed the view that the *Conceptual Framework* should not include recognition criteria—that is, if something meets the definition of an asset or liability, it should, at least in concept, be recognised. Decisions not to recognise a particular asset or liability would be made at the Standards level on the basis of cost-benefit considerations.

32. Some ASAF members expressed the view that reliability should be retained as a qualitative characteristic and that assets and liabilities should be recognised only if they can be measured reliably. Some ASAF members stated that they do not believe that measurement uncertainty makes information less relevant and that the level of measurement uncertainty is a factor in determining whether information can be a faithful representation. An IASB member

questioned whether reintroducing reliability as a qualitative characteristic would result in different recognition criteria.

33. However, some ASAF members expressed support for the proposed recognition criteria and, in particular, for the removal of the probability criterion.

34. Some ASAF members stated that they found the discussion of the different types of uncertainty (existence, outcome and measurement uncertainty) in the *Conceptual Framework* ED to be confusing and expressed the following views:

    (a) existence uncertainty would be better dealt with in the definitions of assets and liabilities.

    (b) in practice, existence, outcome and measurement uncertainty are likely to coexist. Thinking about them separately is not very useful. The IASB staff noted that the *Conceptual Framework* acknowledges this point.

    (c) it is unclear what level of uncertainty would lead to non-recognition. Sometimes the *Conceptual Framework* ED refers to 'low probability'; in other cases it refers to 'very low probability'.

35. One ASAF member stated that it was unclear how the proposed recognition criteria (which are written in terms of assets and liabilities) would apply to income and expenses. The IASB staff noted that the *Conceptual Framework* ED proposes that the IASB (and others) should consider the information provided in the statement(s) of financial performance (as well as the statement of financial position) when making decisions about recognition and measurement.

36. In response to comments from ASAF members, the IASB staff remarked that:

    (a) it is important to tie the recognition criteria back to the qualitative characteristics of useful financial information.

    (b) the proposed material on recognition refers to both a low probability of outflow and a high degree of measurement uncertainty. It states that both these factors are indicators that recognition of a particular item may not provide relevant information, but the proposed material does not set these two factors as rigid recognition criteria that must be met in all cases. For example, relevant information may sometimes result from recognising an out-of-the-money option or a derivative that is difficult to measure.

    (c) the IASB would use the recognition criteria in the *Conceptual Framework*, and the supporting discussion, to develop recognition criteria in particular Standards.

    (d) existence uncertainty does not arise for the vast majority of assets and liabilities. The most obvious case in which it arises is for litigation. Because it arises only in unusual circumstances, if existence uncertainty needs to be addressed, this would be done best in particular Standards.

(e) as explained in paragraph BC5.45 of the *Conceptual Framework* ED, the proposals would neither require nor prohibit a symmetrical approach that would set the same level of measurement uncertainty as being tolerable for the recognition of both income and expenses.

(f) it is the combination of outcome/impact/probability and measurement uncertainty that is likely to drive relevance decisions, not these factors alone. Highly unlikely outcomes that have a material impact are likely to be relevant.

Derecognition

37. ASAF members were asked whether they agreed with the proposed discussion of derecognition in the *Conceptual Framework* ED. That discussion states that accounting requirements for derecognition should aim to represent faithfully both the assets and liabilities retained after a derecognition transaction or event and the resulting change in an entity's assets and liabilities. The *Conceptual Framework* ED goes on to explain that in most cases both aims can be achieved by derecognising an asset or liability when control is lost or the entity no longer has a present obligation. However, there are cases in which it is difficult to represent faithfully both the assets and liabilities retained and the change in an entity's assets and liabilities. In such cases, to provide useful information to users, the IASB may need to consider separate presentation, additional disclosure or even continued recognition.

38. While some ASAF members expressed support for the proposed approach to derecognition, many stated that the IASB should adopt a 'control' approach whereby assets (liabilities) are derecognised if control of the asset is lost (the entity no longer has a present obligation). Some IASB members questioned whether this would be a practical approach, given that we know that there are cases in which the IASB (and others) would want not to derecognise assets even though the reporting entity has lost control (for example, sale and repurchase transactions—repos). Some ASAF members suggested that such cases could be dealt with by explaining more clearly what it means to lose control of an asset and that a temporary loss of control should not be treated in the same way as a permanent loss of control.

39. One ASAF member suggested that, when it is difficult to represent faithfully both the assets and liabilities retained and the change in an entity's assets and liabilities, precedence should be given to faithfully representing the change in the entity's assets and liabilities. This reflects that member's view that information about financial performance is more important than information about financial position.

40. One ASAF member suggested that the discussion of contract modifications would be better integrated into the rest of the recognition and derecognition chapter and another member questioned the need for the discussion, given the proposed derecognition requirements.

Profit or loss versus OCI

41. Françoise Flores presented a paper developed by EFRAG on the reporting of income or expense in profit or loss or OCI. The paper proposes that an entity's business model should drive decisions about measurement and the use of OCI. The paper discusses four business models and their implications for decisions about measurement and the use of OCI.

42. ASAF members thanked EFRAG for preparing the paper.

43. Some ASAF members expressed support for the idea that an entity's business model should drive decisions about measurement bases and the use of OCI. However, others suggested that other factors should also be considered.

44. Some ASAF members, and some IASB members, disagreed with the suggestion in the paper that the use of dual measurement and, hence, the use of OCI should be expanded. They stated that OCI is not well understood by investors and so expanding its use would be unlikely to provide better information to investors.

45. On recycling:

    (a) one ASAF member stated that all income and expenses included in OCI should be recycled.

    (b) an IASB member questioned whether recycling should be based on realisation. The member stated that the point in time when an asset is realised (and hence when the associated income and expense is included in profit or loss) can be manipulated. An ASAF member stated that a better way of thinking about what should be reported in profit or loss may be to consider whether there are any impediments to a sale (instead of whether a sale has been realised).

    (c) one ASAF member stated that the pressure to recycle to profit or loss is largely driven by investors' focus on earnings per share (EPS).

46. The following comments were made on the four business models described in the paper:

    (a) one ASAF member stated that the business models proposed in the paper are unclear and too complex. A residual category may be required for the business models that do not clearly fall into the four models described.

    (b) one IASB member stated that identifying an entity's business model is difficult and, hence, the proposals in the paper would be difficult to apply in practice.

    (c) an IASB member, and a few ASAF members, disagreed with the suggestion in the paper that changes in value in the period are not relevant to the performance of an entity whose business model is a long-term investment.

47. One ASAF member suggested that the use of the business model concept should be explored further and thought should be given to whether it should be identified as a factor to consider

in the chapter of the *Conceptual Framework* dealing with the qualitative characteristics of useful information.

48. Some ASAF members stated that further work is needed on profit or loss and OCI but that any such work should not hold up completion of the *Conceptual Framework*. If necessary, material could be added to the *Conceptual Framework* at a later date—recognising that the *Conceptual Framework* is not a static document. An IASB member suggested that further work is needed on reporting financial performance in general (and not merely on the use of OCI). An ASAF member suggested that it may be more useful to think about the distinction between operating profit and non-operating profit instead of focussing on what should be reported in OCI.

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

49. The IASB staff introduced papers outlining the IASB's research project on IAS 37. The staff provided an overview of the project and explained the purpose of the discussion, which was to obtain initial views of the ASAF on whether the IASB should start an active project to amend IAS 37 and, if so, what the scope of that project should be.

50. The ASAF members generally agreed that the papers correctly identified the range of issues that could be addressed in a project to amend IAS 37.

51. Some ASAF members expressed views on the matters that were most important for the IASB to address. The views expressed by those ASAF members included the following:

    (a) the project should address guidance in IAS 37 related to identifying present obligations, which does seem to be contradictory and thus has resulted in inconsistency in IFRS.

    (b) the project should include an assessment of the implications of the proposals in the IASB's previous ED on IAS 37, and in particular their implications for identifying liabilities and for measuring the fulfilment value. Several of the ASAF members suggested that the review of IAS 37 should apply a holistic approach: amendments should not be carried out on a fragmented basis.

    (c) the project should include a review of the onerous contracts guidance in IAS 37. In particular, it should address the unit of account and costs that should be included in onerous contract liabilities.

    (d) the project could carve out 'litigation claims' and address those separately.

    (e) the project should consider both initial and subsequent measurement of liabilities and try to achieve more consistency with the requirements in IFRS 3 *Business Combinations*.

    (f) guidance on discount rates and risk considerations needed to be enhanced.

    (g) the IASB should consider addressing not only the credit (or liability) perspective, but also the debit (expense or asset) side of the accounting treatment.

(h) the project should revisit the terminology that is currently used in IAS 37. Some of the terminology has proved difficult to translate meaningfully into some languages.

52. ASAF members expressed differing views on whether the project should consider amendments to the recognition criteria in IAS 37. One member noted that the recognition criteria in IAS 37 are different from those for financial assets. That member thought that the project to amend IAS 37 should try to address the inconsistency. However, some other members thought that the current recognition criteria in IAS 37 are working fine and there is no need to revisit them.

Disclosure Initiative

Principles of Disclosure project—content of the Discussion Paper

53. The IASB staff introduced a paper describing the content of the *Principles of Disclosure* Discussion Paper (DP), which included an overview of the issues to be discussed in the DP and the IASB's tentative views on those issues. The staff sought the ASAF members' views on whether there were any other issues that should be included in the DP.

54. The ASAF members expressed strong support for the Principles of Disclosure project and thought that the content of the DP was generally comprehensive. However, they also made some observations on the content of the DP and provided suggestions for additional issues to be considered in the DP and the broader Disclosure Initiative, including:

    (a) the importance of the IASB developing a 'disclosure framework' that would help it to develop IFRS disclosure requirements.

    (b) support for addressing the issue of non-IFRS information and the presentation of performance measures. Most members agreed that the IASB should work closely with regulators on this issue.

    (c) the discussion on cross-referencing in the DP should:

        (i) not include a discussion about cross-referencing to immaterial information; and

        (ii) propose a general principle for cross-referencing that is limited to information within the annual financial report, particularly in view of assurance issues associated with referencing information outside the annual financial report.

    (d) the importance of addressing the role and the boundaries of the notes to the financial statements and the relationship between the notes and the management commentary. In addition, a few members suggested that the IASB should also clarify the relationship between different forms of reporting within the current annual reporting package, such as integrated reporting and sustainability reporting.

    (e) a few members suggested that the DP should provide clear direction to preparers about giving due consideration to the understanding of significant transactions, balances and events of an entity, as their initial assessment of what information to provide within the financial statements (ie a more holistic top-down approach). This would provide a welcome departure from the more checklist-oriented bottom-up approach currently practised when deciding the content and the structure of the notes.

(f) a few members insisted that the guidance on the format of disclosures should aim to be more practical instead of principle-based and should articulate what formatting options should be considered in presenting both quantitative and qualitative information.

55. One ASAF member suggested that accounting and disclosure requirements for changes in accounting policies and accounting estimates should be considered as part of the Principles of Disclosure project rather than as a separate project. This is because the judgement as to whether a change in an entity's accounting practice should be regarded as changes in accounting policies or not would, in part ,relate to the disclosure of such accounting policies.

56. The IASB staff also clarified the reasoning behind the IASB's decision to address the comprehensive review of IAS 7 *Statement of Cash Flows* in the Primary Financial Statements project and to address the proposed amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* within a separate ED, thereby deciding not to include either of these discussions within this DP.

IFRS Taxonomy discussion

57. The IASB staff introduced a paper discussing proposed changes to the IFRS Taxonomy due process. These proposed changes include:

(a) IASB approval of changes to the IFRS Taxonomy that reflect changes to new or amended Standards; and

(b) exposing these proposed changes to the IFRS Taxonomy at the same time as an ED in the form of an *IFRS Taxonomy Update*, which is material accompanying the ED.

58. The IASB staff highlighted that this proposal was recently trialled on the ED *Disclosure Initiative* (Amendments to IAS 7). The feedback received from this trial, as well as feedback from ASAF members and the IASB at its meeting in September, will be used to develop an IASB staff recommendation to the Due Process Oversight Committee (DPOC) at its October meeting. Proposed changes to the IFRS Taxonomy due process that are approved by the DPOC will be subject to public consultation.

59. The views expressed by ASAF members included:

(a) concern that the quality of the IFRS Taxonomy would be compromised if there was no public exposure of how the changes related to the final Standard were reflected in the IFRS Taxonomy. This would particularly be the case if the disclosure requirements in the final Standard were significantly different from the ED.

(b) concern that some projects have more than one ED and, as a result, asking respondents to comment on multiple versions of the IFRS Taxonomy may result in an inefficient use of resources. It was highlighted that respondents may be reluctant to comment if the expectation is for them to comment on multiple versions. In their view, commenting on the IFRS Taxonomy on the basis of the final Standard should be sufficient and might encourage more responses.

(c) one member's view was that more work needs to be done to align the development processes of the Standard and the IFRS Taxonomy. Historically, standard-setters have focussed primarily on standard-setting and have paid little or no attention to the interaction between technology and standard-setting. That member expects greater debate in this area in the near future.

Accounting for dynamic risk management: a portfolio revaluation approach to macro hedging

60. The IASB staff presented an update on the project on Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging, including a summary of the feedback received on the DP. The IASB staff noted that at the May 2015 IASB meeting the IASB discussed the next steps for the project and that the IASB had tentatively decided to first consider how the information needs of constituents concerning dynamic risk management activities could be addressed through disclosures, before considering which areas that need to be addressed through recognition and measurement. Consequently, the staff noted that this was not a disclosures-only project. At that meeting, the IASB also tentatively decided to prioritise the consideration of interest rate risk.

61. The IASB staff then asked for the ASAF members' comments on:

(a) any additional information needs relating to an entity's dynamic risk management of interest rates that are not included in the summarised feedback received on the DP; and

(b) possible additional sources of information that the IASB staff could consult for ascertaining such information needs other than:

(i) comment letters to the DP;

(ii) the usual channels such as outreach with users, preparers, regulators, national standard-setters and academics; and

(iii) reviewing existing GAAP and non-GAAP measures and regulatory requirements.

62. The ASAF members made the following comments:

(a) the clarification by the IASB staff about this not being a disclosures-only project was welcome.

(b) on the basis of that feedback, it could be noted that there was little support for the portfolio revaluation approach (PRA) being an objective in itself but there was support for fixing accounting mismatches arising because derivatives are measured at fair value through profit or loss and the hedged items are measured at amortised cost.

(c) a recommendation to think about why this project was started in the first place. IFRS 9 does not sufficiently address hedge accounting for open portfolios because it was too difficult to solve this issue in the short term. Consequently, entities are continuing to use IAS 39 hedge accounting requirements, which are complex, not very intuitive and do not reflect the actual economics of their hedging activities.

(d) a recommendation that the IASB staff do not restrict their thinking about disclosures to the current accounting framework.

(e) one ASAF member stated that net interest income (NII) is a big focus for banks. This member mentioned that users want to understand the hedged and unhedged interest rate positions and the effect of the hedging. This member mentioned that work regarding recognition and measurement should continue, because focussing only on disclosures would not be enough from the preparers' point of view.

(f) one ASAF member mentioned that the task is difficult, because preparers and users have different needs and concerns. There is a need for a compromise, but any solution will probably disappoint both. An approach to explain better what has happened in the financial statements will improve the current understanding. However, the accounting mismatch problem still needs to be addressed.

(g) one ASAF member was sceptical about the approach being followed in the project (information needs first and recognition and measurement subsequently). They wondered whether there were any issues about considering everything together (disclosures and recognition and measurement). The IASB staff commented that the approach was selected in the hope that this would improve decisions on recognition and measurement once the information needs were fully understood.

(h) one ASAF member wondered whether behaviouralisation of demand deposits could be introduced in IFRS 9. From their point of view, incorporating this flexibility into IFRS 9 would solve many problems.

(i) one ASAF member recommended concentrating not only on information needs but also on an entity's objectives behind its hedging operations. What entities aim to do is to achieve a degree of stability of earnings over a period.

(j) one ASAF member mentioned that they were not concerned about allowing entities different accounting choices . According to this member, the benefits arising from this flexibility were seen as highly valuable and transparency and lack of comparability could be tackled with sufficient disclosures.

(k) one ASAF member saw the project as not being about dynamic risk management, but that it was about being able to better understand the interest rate risk of financial institutions. Consequently, they felt that the focus should be on looking at what we are missing in the accounting information.

63. Some ASAF members also raised the following concerns:

(a) two ASAF members asked whether the project should consider other risks and not only interest rate risk (for example, there are also industries that carry out dynamic risk management of commodity price risk such as, for example, utility companies).

(b) another ASAF member questioned the approach chosen. From their point of view, the project should focus on reducing the complexity of the current hedge accounting requirements within the context of open portfolios and not on merely faithfully representing an entity's dynamic risk management activities.

64. One ASAF member provided suggestions on additional information needs. This member mentioned that they had observed that banks disclose information trends on NII and net interest margin and that those banks include some commentary between these two. As an additional source, this ASAF member suggested having a look at investors' presentations and at work carried out by the CFA Institute on users' information needs.

Pollutant pricing mechanisms (formerly emissions trading schemes)

65. At this meeting, the ASAF members:

(a) focussed on a cap-and-trade type of emissions trading scheme (ETS); and

(b) provided views about possible accounting approaches using a simple example of a cap-and-trade ETS. The example and some possible approaches are contained in ASAF Agenda Paper 7B.

66. The member from China introduced Agenda Paper 7C *China's New Proposal on Accounting for Emission Trading Schemes*, which uses the same example as the one contained in Agenda Paper 7B to demonstrate an additional possible approach. The approach suggests:

(a) When a participant entity receives allowances from the government free of charge, it should recognise the allowances at fair value but also recognise a liability for the same amount. This liability would represent the obligation to comply with the scheme (see paragraph 7).

(b) As the entity emits the specified pollutants, it creates an obligation to remit allowances back to the government, equal in quantity to the volume of pollutants emitted. This obligation should be recognised as a liability, measured at the present value of the allowances. This liability gradually replaces the initial liability recognised.

(c) The allowances asset and the two liabilities would subsequently be measured at fair value, with the remeasurement being recognised in profit or loss.

(d) If, as in the simple example, the volume of pollutants emitted equals the quantity of allowances received free of charge from the government, there is a fully effective hedge. As a result, there will be no gain or loss to recognise in profit or loss.

(e) If the volume of pollutants emitted does not, or is not expected to, equal the quantity of allowances received free of charge, there is an ineffective hedge. Using the proposed approach, a gain or loss resulting from the ineffective portion of the hedge will be recognised in profit or loss.

67. ASAF members generally agreed that the introduction of a cap-and-trade ETS imposed new restrictions and potential costs on a participant entity. Consequently, most members think that recognising a 'Day 1 gain' in profit or loss would not faithfully represent the economics of the scheme. The allocation of allowances free of charge from the government should not result in a gain; instead, many members consider that it is a mechanism designed to reduce the entity's costs imposed by the scheme, or an incentive to encourage reduction of emissions.

68. Many ASAF members expressed a preference for an approach that would result in no gain or loss being recognised in profit or loss during the compliance year, when there is a fully effective hedge between the quantity of pollutants emitted and the allowances allocated free of charge by the government.

69. Many ASAF members support measuring the allowances at fair value. This approach recognises that that the allowances can be used to generate cash, as well as to settle the obligation to remit allowances to the government equal to the volume of pollutants emitted. This, in effect, considers the allowances to be similar to a 'foreign currency'.

70. Many ASAF members also support measuring at fair value the liability to remit allowances to the government equal to the volume of pollutants to be emitted. This, it is suggested, is consistent with a liability recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

71. A question remained about how to describe the initial liability described in Agenda Paper 7C (see paragraph 2(a)) and how it fits the definition of a liability in the *Conceptual Framework*. The IASB staff will carry out a further analysis to bring to a future ASAF meeting.

72. Some ASAF members expressed a preference for Approach 5 in Agenda Paper 7B. In this approach, the allowances and related liabilities would be measured using a historical cost approach, instead of remeasuring them at fair value. In cases in which the allowances are measured at nil because they were received free of charge from the government, this would effectively result in the allowances and related liabilities not being recognised in the financial statements.

73. Some ASAF members suggested that this approach is less transparent and provides less useful information to users of financial statements. They suggest that recognising the allowances and related liabilities separately and measuring the allowances at fair value would more

faithfully represent the choices that the entity has available when deciding whether and when to trade or hold allowances . Separate recognition could also support better understanding of the entity's obligations, if the government were to change its policy on providing allowances.

74. Some ASAF members suggested a 'business model' approach. Allowances that are held for trading would be measured at fair value through profit or loss. Allowances that are held for compliance purposes to settle the entity's obligation to remit allowances to the government equal to the volume of pollutants emitted would be measured at historical cost. In cases in which an entity receives, free of charge, an allocation of allowances from the government that it will use for compliance purposes, instead of selling the allowances through the market, one ASAF member did not believe that the allocation creates an asset or a liability. Many ASAF members consider that using a business model approach (distinguishing allowances held for compliance from allowances held for trading) would add complexity to the model and create difficult accounting issues in cases in which management intention changes or allowances are used for both trading and compliance purposes through the reporting period.

Next steps

75. The IASB staff will bring proposals for an accounting model (or models) to a future ASAF meeting, together with an analysis of how the model(s) fits the *Conceptual Framework* and existing IFRS.

Rate-regulated activities

76. At this meeting, the ASAF members provided views about possible accounting approaches that could be developed to reflect the financial effects of a type of rate regulation described as 'defined rate regulation' in the Discussion Paper *Reporting the Financial Effects of Rate Regulation*, published in September 2014. ASAF members used a simplified numerical example to consider how to account for a situation in which three specified activities carried out by the entity during a period were reflected in the revenue billed to customers in a different period. The example is contained in ASAF Agenda Paper 8.

77. The example highlighted three specified activities for which the consideration was included in the revenue requirement calculation, and, consequently, in amounts billed to customers, either in arrears or in advance of the entity incurring the costs involved in carrying out the activities. The specified activities are:

    (a) repairing damage to the entity's own assets caused by a flood, with the associated consideration being billed in a later period;

    (b) carrying out a research project, with the associated consideration being billed partly in advance; and

    (c) constructing property, plant and equipment (PPE), with the associated consideration being billed partly in advance and partly in arrears.

78. ASAF Agenda Paper 8 asked ASAF members to comment on whether it would be appropriate to amend the existing predominant IFRS practice. This practice focuses only on the contractual relationship between the entity and its customers. It makes no adjustment to reflect the effects of the regulatory agreement between the entity and the rate regulator. As a result, the revenue that the entity recognises in its IFRS financial statements reflects the quantity (Q) of rate-regulated goods or services delivered to customers during the period (that is, the satisfaction of the entity's performance obligations to its customers), multiplied by the regulated rate per unit (P).

79. ASAF members expressed mixed views about whether any adjustment to the existing predominant IFRS practice is needed at all. Some who considered that there should be no adjustment were not convinced that the regulatory relationship between the entity and the rate regulator was sufficiently strong to override the accounting provided by the existing practice. This is particularly so in situations in which the rate regulator provides no guarantee that any shortfall in the cash flows provided through amounts billed to customers would be made up in cash by the rate regulator.

80. Others who did not support an adjustment to the existing practice did not object on conceptual grounds. Instead, they suggested that the population of entities that may fall within the scope of defined rate regulation could be so small that the cost of developing an accounting model that adjusted the existing predominant IFRS practice would outweigh the benefits.

81. ASAF members who supported making adjustments to the existing predominant IFRS practice had mixed views about when, and why, adjustments should be made. However, most ASAF members who support an adjustment would prefer to see an adjustment to the timing of recognition of income, with little support for an adjustment to the timing of recognition of costs. Many ASAF members also expressed a preference for any adjustment to be presented as a separate 'regulatory adjustment' in the financial statements, instead of being offset against the amount of revenue recognised from contracts with customers (P x Q).

82. Some ASAF members who supported making adjustments to the existing predominant IFRS practice were comfortable with recognising a 'regulatory liability' in cases in which the consideration was included in amounts billed to customers in advance of the entity carrying out the specified activity. This would be analogous to treating the specified activity as satisfying a 'performance obligation' to the customers and recognising a 'contract liability' for the unsatisfied portion of the obligation.. In contrast, they were not comfortable with recognising a 'regulatory asset' when the activity was carried out in advance of billing to customers. This suggested a preference for recognising the related consideration at the later of:

(a) billing customers; and

(b) carrying out the specified activity.

83. In one example, the amounts billed to customers relate to construction of the entity's own PPE. That example raised some questions about the nature of the activity to which the relevant consideration related. Some considered it to be the actual construction activity itself. Others considered that it may be the subsequent delivery of goods or services to customers using the constructed property, plant and equipment. In the latter case, the consideration would be recognised as a regulatory liability and subsequently released to profit or loss account systematically over time, as the PPE is consumed in the production and delivery of goods or services to customers.

Next steps

84. The IASB staff will bring proposals for an accounting model (or models) to a future ASAF meeting, together with an analysis of how the model(s) fit(s) the *Conceptual Framework* and existing IFRS.

IFRS 15 *Revenue from Contracts with Customers*

85. The IASB staff provided an overview of the recent developments relating to the new revenue Standard, IFRS 15 *Revenue from Contracts with Customers*. This included an update about the activities of the Transition Resource Group, the feedback from the comment letters on the ED *Effective Date of IFRS 15* and an overview of the forthcoming ED *Clarifications to IFRS 15*. With respect to the latter, the staff explained that the IASB and the US Financial Accounting Standards Board (FASB) had recently decided to make the same clarifications to the requirements for principal versus agent considerations and the supporting examples. Lastly, the IASB staff provided an overview of the similarities and differences between the IASB's and the FASB's proposed and expected clarifications to the new revenue Standard.

86. An ASAF member noted the feedback from their constituents, which highlighted the importance they placed on the IASB and the FASB maintaining convergence on this project.

IASB project update and agenda planning

87. The IASB staff presented an overview of the IASB's current projects, a summary of the actions taken on the advice provided by the ASAF in previous meetings and the suggested agenda topics for the July and October 2015 meetings.