IASB® *Update*

From the International Accounting Standards Board

November 2016

Welcome to the November IASB *Update*

This IASB *Update* highlights preliminary decisions of the International Accounting Standards Board (the Board). The Board's final decisions on Standards, Amendments and Interpretations are formally balloted as set forth in the IFRS® Foundation and IFRS Interpretations Committee *Due Process Handbook*.

The Board met in public from 14 to 16 November 2016 at the IFRS Foundation's offices in London, UK.

The topics for discussion were:

- **Disclosure Initiative: Materiality Practice Statement**
- ***Conceptual Framework***
- **Primary Financial Statements**
- **Maintenance of IFRS Standards**
- **Financial Instruments with Characteristics of Equity**
- **Insurance Contracts**

Contact us

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Tel: +44 (0)20 7246 6410
Fax: +44 (0)20 7246 6411
E-mail: **info@ifrs.org**
Website: **www.ifrs.org**

Future IASB meetings

The Board meets at least once a month for up to five days.

The next IASB meetings are:

12 to 16 December 2016
16 to 20 January 2016
20 to 24 February 2016

To see upcoming and past IASB meetings, **click here**.

Archive of IASB *Update* Newsletter

For past issues of IASB *Update* **click here**.

Podcast summaries

To listen to a short Board meeting audio summary (Podcast) of previous Board meetings, **click here**.

Disclosure Initiative: Materiality Practice Statement (Agenda Paper 11)

The Board met on 14 November 2016 to discuss the comments on the Exposure Draft IFRS Practice Statement: *Application of Materiality to Financial Statements* (the draft Practice Statement).

The draft Practice Statement was published in October 2015 with a 120-day comment period. The objective of the draft Practice Statement was to assist management in applying the concept of materiality to general purpose financial statements prepared applying IFRS Standards.

Agenda Paper 11A: Errors

The Board discussed guidance on the application of materiality to errors. The Board tentatively decided to:

a. suggest that entities apply the ‘Materiality Process’ (as described in Agenda Paper 11D presented to the Board in October 2016) to assess whether an error is material. Ten of 11 Board members agreed and one member disagreed with this decision.
b. clarify that the assessment of the materiality of a ‘cumulative error’ should be based on conditions existing when the financial statements for the period are authorised for issue. Six of 11 Board members agreed and five members disagreed with this decision.
c. avoid providing guidance on how to correct a material cumulative error. Six of 11 Board members agreed and five members disagreed with this decision.
d. remove guidance from the Practice Statement implying that an error is always material if it is made intentionally to achieve a particular presentation or result. Ten of 11 Board members agreed and one member disagreed with this decision.

Agenda Paper 11B: Covenants

The Board discussed the impact of covenants on the application of materiality. The Board tentatively decided to:

a. include in the Practice Statement specific guidance on how to assess the materiality of information about the existence and the terms of a covenant, or a covenant breach; and
b. emphasise that, in making the above assessment, an entity may consider the consequences of a breach on the entity’s financial position, financial performance and cash flows; and the likelihood of the breach occurring.

Ten of 11 Board members agreed and one member disagreed with these decisions.

Agenda Paper 11C: Stewardship

The Board discussed how stewardship could be considered when applying materiality.

The Board noted that information needed to assess the stewardship of management is necessary to meet the objective of financial reporting. The Board tentatively decided that, in assessing materiality of information, an entity should consider whether that information is needed to assess stewardship.

Ten of 11 Board members agreed and one member disagreed with this decision.

Agenda Paper 11D: Recognition and measurement

The Board discussed the application of materiality in the context of recognition and measurement together with proposed changes to the guidance on the role of practical expedients in the application of materiality. The Board tentatively decided to:

a. include guidance on the application of materiality in the context of recognition and measurement throughout the Practice Statement, rather than in a separate section. Nine of 11 Board members agreed and two members disagreed with this decision.
b. retain in the Practice Statement examples of the application of materiality in the recognition and measurement, or disclosure, of information included in the financial statements. Seven of 11 Board members agreed and four members disagreed with this decision.

Agenda Paper 11E: Entities applying the IFRS for SMEs® Standard

The Board discussed the applicability of the Practice Statement to entities applying the *IFRS for SMEs* Standard. The Board tentatively decided that the Practice Statement is not intended for entities applying the *IFRS for SMEs* Standard.

All 11 Board members agreed with this decision.

Agenda Paper 11F: Status and form of the guidance

The Board discussed the status (ie mandatory versus non-mandatory) and the form that the guidance on applying the concept of materiality to IFRS financial statements should take.

The Board tentatively decided to confirm that the guidance on applying the concept of materiality to IFRS financial statements would be issued as an IFRS Practice Statement, ie as non-mandatory guidance.

All 11 Board members agreed with this decision.

Next steps

At a future meeting the Board is expected to once again discuss guidance on the application of materiality to prior period information; the staff will also bring a paper summarising the due process steps completed to date.

Conceptual Framework (Agenda Paper 10)

On 15 November 2016 the Board discussed:

1. comments received on the Exposure Draft *Conceptual Framework for Financial Reporting* (the Exposure Draft). Specifically, it discussed comments received on the proposed liability definition and supporting concepts; and
2. the results of work performed to identify the potential effects on preparers of financial statements of the proposed changes to the *Conceptual Framework*.

Agenda Paper 10C: Liability definition and supporting concepts—the 'no practical ability to avoid' criterion

The Board tentatively decided that, as proposed in the Exposure Draft, the concepts supporting the liability definition should specify that the entity must have 'no practical ability to avoid' transferring an economic resource.

Ten of 11 Board members agreed and one member disagreed with this decision.

Additionally, the Board tentatively decided:

a. to refine the concepts on the meaning of 'no practical ability to avoid' proposed in paragraph 4.32 of the Exposure Draft. The refined concepts should state that, to conclude that an entity has 'no practical ability to avoid' a transfer:
    i. the factors considered would depend on the type of transaction under consideration. For example, for some types of transaction, an entity may have no practical ability to avoid a transfer if all avoiding actions would have economic consequences significantly more adverse than the transfer itself.
    ii. it would never be sufficient that the management of the entity intends to make the transfer or that the transfer is probable.

    Ten of 11 Board members agreed and one member disagreed with this decision.

b. to add no further concepts on the meaning of 'no practical ability to avoid' to the *Conceptual Framework* beyond those proposed in the Exposure Draft. Although more detailed requirements and guidance might be needed to apply the 'no practical ability to avoid' criterion, the requirements and guidance would depend on the type of transaction under consideration and so would be more appropriately developed if and when the Board is developing an IFRS Standard for that type of transaction.

    All 11 Board members agreed with this decision.

Agenda Paper 10D: Liability definition and supporting concepts—reducing the risk of further changes

The Board considered refinements to the Exposure Draft proposals to reduce the risk of adding to the *Conceptual Framework* new concepts that the Board may need to change as a result of decisions it makes in its project on Financial Instruments with Characteristics of Equity. It tentatively decided not to add to the revised *Conceptual Framework*:

a. two statements in the Exposure Draft that would apply in practice only to questions of how to distinguish liabilities from equity claims:
    i. a statement in paragraph 4.33(b) of the Exposure Draft that, if an entity prepares financial statements on a going concern basis, that entity does not have a liability for a transfer that would be required only on liquidation.
    ii. a statement in paragraph 4.30 of the Exposure Draft that an obligation of an entity to transfer its own equity claims to another party is not an obligation to transfer an economic resource (paragraph 4.30). That statement implies that an obligation of an entity to transfer its own equity instruments never constitutes a liability (even if the obligation requires the transfer of a variable number of equity instruments with a fixed total value), which is inconsistent with existing IFRS requirements.
b. the description of a present obligation proposed in paragraph 4.31 of the Exposure Draft. The two criteria identified in that description—the 'no practical ability to avoid' criterion and the 'as a result of past events' criterion—would continue to be identified as necessary characteristics of a liability (as discussed in paragraphs 4.32-4.39 of the Exposure Draft). But, by not including that description, the revised *Conceptual Framework* would avoid implying that any claim with these two characteristics is necessarily a liability, as opposed to an equity claim.

All 11 Board members agreed with these decisions.

Agenda Paper 10E: Liability definition and supporting concepts—other topics

Concepts explaining the meaning of 'as a result of past events'

The Board tentatively decided that, to clarify the meaning of the phrase 'as a result of past events' in the definition of a liability, the revised *Conceptual Framework* should:

a. refer to an activity of the entity 'that will or may oblige it to transfer an economic resource that it would not otherwise have had to transfer', instead of the activity 'that establishes the extent' of the entity's obligation (as was proposed in the Exposure Draft).
b. include clarification that the enactment of a law (or the introduction of some other enforcement mechanism, policy or practice, or the making of a statement) is not in itself sufficient to give an entity a present obligation. The entity must have conducted an activity to which a present law (or other present enforcement mechanism, policy, practice or statement) applies.

Nine of 11 Board members agreed and two disagreed with this decision.

Other topics

The Board tentatively decided that, as was proposed in the Exposure Draft:

a. the definitions of an asset and a liability should include both the term ‘present’ and the phrase ‘as a result of past events’. Ten of 11 Board members agreed with this decision. One Board member was absent.
b. the concepts supporting the liability definition should not require a ‘present claim’ against the entity by another party. All 11 Board members agreed with this decision.
c. the revised *Conceptual Framework* should include the concepts proposed in paragraphs 4.25 and 4.26 of the Exposure Draft on the correspondence between assets and liabilities. All 11 Board members agreed with this decision.
d. the revised *Conceptual Framework* should not contain concepts that specifically address non-reciprocal transactions. All 11 Board members agreed with this decision.

Drafting of concepts on existence uncertainty

The staff also highlighted the discussion of existence uncertainty in the Exposure Draft. The staff explained that they planned to split this discussion between two chapters in the revised *Conceptual Framework*:

a. the discussion of the consequences of existence uncertainty for recognition would remain in the chapter discussing recognition (Chapter 5); but
b. the discussion of how existence uncertainty arises would be moved to the chapter on identifying assets and liabilities (Chapter 4).

Agenda Paper 10G: Effects of proposed changes to the Conceptual Framework on preparers

The Board discussed the results of work performed by the staff to identify whether, and if so how, preparers’ accounting policies would be affected by replacing references to the *Framework for the Preparation and Presentation of Financial Statements* with references to the *Conceptual Framework for Financial Reporting* in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

No decisions were made at the Board meeting.

Next steps

At the December 2016 meeting, the Board plans to discuss:

a. derecognition;
b. measurement;
c. capital maintenance; and
d. business activities and long-term investment.

The Board also plans to discuss the Exposure Draft *Updating References to the Conceptual Framework*.

Primary Financial Statements (Agenda Paper 21)

Agenda Paper 21: Primary Financial Statements

On 15 November 2016 the Board discussed the results of initial research, including outreach with investors, to help define the scope of the Primary Financial Statements project. No tentative decisions were made.

Next steps

At the December 2016 Board meeting, the Board will discuss the scope of the project.

Maintenance of IFRS Standards (Agenda Paper 12)

The Board met on 15 November 2016 to discuss maintenance projects.

IAS 28* Investments in Associates and Joint Ventures*—Long-term interests—Due process steps (Agenda Paper 12A)

At its October 2016 meeting, the Board tentatively decided to include in *Annual Improvements to IFRS Standards 2015–2017 Cycle* proposed amendments to IAS 28 *Investments in Associates and Joint Ventures*.

At this meeting, November 2016, the Board tentatively decided that the comment period for the proposed amendments to IAS 28 should be no less than 90 days. All 11 Board members agreed with this decision.

All 11 Board members confirmed they were satisfied that the Board had complied with the necessary due process requirements in developing the proposed amendments. Consequently, the Board instructed the staff to begin the balloting process. One Board member indicated his intention to dissent from the proposed amendments to IAS 28.

Next steps

The Board expects to publish the Exposure Draft of *Annual Improvements to IFRS Standards 2015–2017 Cycle* in January 2017.

Property, Plant and Equipment: Proceeds before intended use—Due process steps (Agenda Paper 12B)

At its October 2016 meeting, the Board tentatively decided to propose an amendment to IAS 16 *Property, Plant and Equipment.*

At this meeting, November 2016, the Board tentatively decided that the comment period for the proposed amendment to IAS 16 should be no less than 120 days. All 11 Board members agreed with this decision.

All 11 Board members confirmed they were satisfied that the Board had complied with the necessary due process requirements in developing the proposed amendment. Consequently, the Board instructed the staff to begin the balloting process. One Board member indicated that he may dissent from the proposed amendment to IAS 16.

Next steps

The Board expects to publish the Exposure Draft of the proposed amendment to IAS 16 in the first half of 2017.

Financial Instruments with Characteristics of Equity (Agenda Paper 5)

The International Accounting Standards Board (the Board) met on 16 November 2016 to discuss the research project on Financial Instruments with Characteristics of Equity (FICE).

The Board was given a summary of discussions to date (Agenda Paper 5A, which was provided for information only).

Agenda Paper 5B: Exception in paragraphs 16A–16D of IAS 32

At this meeting, the Board discussed whether the exception as set out in paragraphs 16A and 16B, or 16C and 16D, of IAS 32 *Financial Instruments: Presentation* is still needed given the classification and presentation requirements of the Gamma approach. The Board noted that one of the objectives of the FICE project is to reinforce the underlying rationale of the distinction between liabilities and equity in IAS 32, but not to perform a fundamental review of IAS 32. Currently, the Board is not aware of any issues with the application of the exception as set out in paragraphs 16A and 16B, or 16C and 16D, of IAS 32. The Board also observed that applying the Gamma approach to instruments that meet the exception might address some, but not all, of the previous concerns which led to the exception. Hence, the exception might continue to be required under the Gamma approach. The Board tentatively decided to include its discussion in the future FICE Discussion Paper.

All Board members agreed with this decision.

Next steps

At a future meeting the Board will discuss:

- substance of rights and obligations in contracts and the interaction with legal and regulatory requirements; and
- recognition, derecognition and reclassification of equity instruments.

Insurance Contracts (Agenda Paper 2)

The Board met on 16 November 2016 to discuss issues that arose during the external testing and drafting of the forthcoming insurance contracts Standard.

Agenda Paper 2A: Methodology—External testing of draft IFRS 17

Agenda Paper 2B: Results—External testing of draft IFRS 17

The Board received two reports on the external testing of draft IFRS 17. The Board was not asked for decisions.

Agenda Paper 2C: Level of aggregation

The Board tentatively decided:

a. to retain the definition of portfolio in draft IFRS 17 *Insurance Contracts*, ie that a portfolio is a group of contracts subject to similar risks and managed together as a single pool. IFRS 17 would provide guidance that contracts within each product line, such as annuities or whole-life, would be expected to have similar risks, and hence contracts from different product lines would not be expected in the same portfolio.
b. to require entities to identify onerous contracts at inception and group them separately from contracts not onerous at inception. IFRS 17 would provide guidance that entities could measure contracts together if the entity can determine that those contracts can be grouped with others based on available information at inception.
c. to require entities to measure insurance contracts not onerous at inception by dividing the portfolio into two groups—a group of contracts that have no significant risk of becoming onerous and a group of other profitable contracts. IFRS 17 would provide guidance that:
    i. an entity should assess the risk of the contracts in a group becoming onerous in a manner consistent with the entity's internal reporting about changes in estimates.
    ii. an entity should assess the risk of contracts in the group becoming onerous based on the sensitivity of the fulfilment cash flows to changes in estimates which, if they occurred, would result in the contracts becoming onerous.
    iii. an entity is permitted to divide a portfolio into more than two groups. For example, an entity may choose to divide a portfolio into more groups if the entity's internal reporting provides information that distinguishes the different risks of contracts becoming onerous.
d. prohibit entities from grouping contracts issued more than one year apart.
e. to require entities to allocate the contractual service margin for a group of contracts on the basis of the passage of time. Thus the contractual service margin should be allocated over the current period and expected remaining coverage period and that allocation should be on the basis of coverage units, reflecting the expected duration and size of the contracts in the group.

These decisions revise the Board's previous decisions on the level of aggregation for the measurement of the contractual service margin.

Ten of the 11 Board members agreed and one member disagreed with these decisions.

The Board tentatively decided that an entity should be permitted to use a weighted average discount rate for the accretion of interest on the contractual service margin, with an averaging period of up to one year.

All 11 Board members agreed with this decision.

Agenda Paper 2D: Experience adjustments

The Board tentatively decided that for contracts measured under the general model:

a. when an experience adjustment directly causes a change in the estimate of the present value of future cash flows, the combined effect of the experience adjustment and the change in the estimate of the present value of the future cash flows should be recognised in profit or loss rather than adjusting the contractual service margin.
b. guidance should be added to IFRS 17 explaining that an experience adjustment directly causes a change in the estimate of the present value of future cash flows only when it causes a change in the future rights and obligations for the group of contracts (ie the number of coverage units), and not just the measurement of those rights and obligations. A change in the measurement only of existing rights and obligations is not directly caused by an experience adjustment.

All 11 Board members agreed with these decisions.

The Board tentatively decided that for contracts accounted for using the variable fee approach, the following should be recognised in profit or loss, rather than adjusting the contractual service margin:

a. experience adjustments arising from non-financial risk that do not affect the underlying items; and
b. any directly caused changes in the estimates of the present value of future cash flows.

All 11 Board members agreed with these decisions.

Agenda Paper 2E: Transition issues Agenda Paper

The Board tentatively decided that:

a. an entity shall apply the requirements of IFRS 17 retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to groups of insurance contracts, unless doing so is impracticable.
b. for insurance contracts for which the entity cannot identify a group retrospectively, and for groups of insurance contracts for which retrospective application is impracticable, the entity is permitted to choose a modified retrospective approach or the fair value approach. If a modified retrospective approach is impracticable, the entity must use the fair value approach.

All 11 Board members agreed with these decisions.

Modified retrospective approach

The Board tentatively decided that:

a. the objective of a modified retrospective approach should be to achieve the closest outcome to retrospective application possible using reasonable and supportable information;
b. an entity should be permitted to use the modifications specified in Appendix B of Agenda Paper 2E, but shall use the minimum modifications necessary to meet the objective of the modified retrospective approach; and
c. in applying a modified retrospective approach, an entity shall maximise the use of information that would have been used to apply a fully retrospective approach but need only use information available without undue cost or effort.

All 11 Board members agreed with these decisions.

Variable fee approach

The Board tentatively decided that the entity should determine the contractual service margin using the permitted modifications for the variable fee approach specified in paragraph B8 of Agenda Paper 2E determined at the beginning of the earliest period presented, rather than at the date of initial application.

All 11 Board members agreed with these decisions.

Fair value approach

The Board tentatively decided that in applying the fair value approach, an entity should be permitted a choice on when to make to make the following assessments (consistent with the modifications recommended for the modified retrospective approach):

a. whether a contract is eligible for the variable fee approach;
b. how to group contracts; and
c. how to determine the effect of discretion on estimated cash flows for contracts subject to the general model.

The entity can make the assessment:

a. as at inception of a contract—based on reasonable and supportable evidence of what the entity would have determined given the terms of the contract and the market conditions at that time; or
b. at the beginning of the earliest period presented.

The Board tentatively decided that in applying the fair value approach (consistent with the modifications recommended for the modified retrospective approach), an entity is:

a. not prohibited from grouping contracts issued more than one year apart; and
b. permitted to use the discount rate at the beginning of the earliest period presented:
    i. to accrete and adjust the resulting contractual service margin for groups of contracts to which the entity applies the general model; and
    ii. to determine the finance income or expenses in profit or loss when the entity makes an accounting policy choice to disaggregate the insurance finance income or expenses between profit or loss and other comprehensive income for non-participating contracts.

All 11 Board members agreed with these decisions.

Disclosures

The Board tentatively decided that an entity should provide all the disclosures required by IFRS 17 relating to:

a. the contractual service margin;
b. insurance contract revenue; and
c. insurance finance income or expense;

separately for:

a. insurance contracts that existed at the beginning of the earliest period presented; and
b. insurance contracts written after the beginning of the earliest period presented.

The Board tentatively decided that an entity should:

a. explain how it determined the measurement of insurance contracts at transition for all periods in which disclosures are provided for insurance contracts that existed at the beginning of the earliest period presented when the entity first applies IFRS 17. The explanation should help users understand the nature and significance of the methods used and judgements applied.
b. disclose a reconciliation from the opening to the closing balance of the cumulative amounts included in other comprehensive income (OCI) for financial assets measured at fair value through OCI if those assets are related through the entity's asset-liability management to those insurance contracts that an entity determines the finance income or expenses in profit or loss using the discount rate at the beginning of the earliest period presented when the entity first applies IFRS 17.

All 11 Board members agreed with these decisions.

Agenda Paper 2F: Risk Mitigation

The Board tentatively decided to permit an entity that uses a derivative to mitigate financial risks arising from an insurance contract accounted for using the variable fee approach to exclude the effect of those changes in the financial risk from the contractual service margin when specified criteria are met.

This extends the approach applicable to specific financial risks included in paragraph B104 of draft IFRS 17 to all financial risks reflected in the insurance contract to which the variable fee approach is applied.

All 11 Board members agreed with this decision.

Agenda Paper 2G: Other sweep issues

The Board agreed with the staff recommendations in Agenda Paper 2G on the remaining sweep issues. Board members did not raise any other topics for staff to consider at a future meeting.

All 11 Board members agreed with these decisions.

Agenda Paper 2H: Mandatory effective date of IFRS 17

The Board tentatively decided that:

a. an entity should apply IFRS 17 for annual periods beginning on or after 1 January 2021, assuming IFRS 17 is issued in the first half of 2017. This would allow 3½ to 4 years from the issuance of IFRS 17 to the mandatory effective date; and
b. an entity may apply IFRS 17 before 1 January 2021, provided that the entity also applies IFRS 9 and IFRS 15 at the same time.

Ten of the 11 Board members agreed and one member disagreed with these decisions.

Next steps

The staff will continue drafting process to:

1. reflect the decisions made in the November 2016 meeting in a revised draft of IFRS 17; and
2. ask selected external parties to perform a fatal flaw review of an updated draft of IFRS 17.

IFRS 17 is expected to be issued in the first half of 2017.

Work plan—projected targets as at 18 November 2016

The work plan reflecting decisions made at this meeting was updated on the IASB website on 18 November 2016.
View it here.

ISSN 1474-2675