Topic **Dealing with the complexity of cross-cutting issues**

Introduction

1. This paper sets out for the Council examples of the type of problem that can affect more than one project or topic within IFRSs—which we refer to as cross-cutting issues—and some of the ways that the Board works to address these matters consistently. Sometimes the Board will allow inconsistencies to emerge (or remain).

2. The objectives of the session at the IFRS Advisory Council meeting are to:

   (a) increase the awareness of Council members of how the IASB deals with cross-cutting issues;

   (b) seek the Council's views on ways that the IASB might deal with cross-cutting issues; and

   (c) help the IASB identify cross-cutting issues that are causing a concern for those applying or using IFRSs.

Recent experiences of cross-cutting issues

3. Cross-cutting issues are, generally, about consistency. A requirement in one IFRS might not be consistent with an equivalent requirement in relation to a similar transaction or event in another IFRS. These inconsistent requirements can lead to financial reporting that is consistent within an industry or activity but inconsistent between 'similar' transactions.

4. Such inconsistencies can make it difficult for those applying IFRSs to identify which requirement should be analogised to a transaction not specifically addressed in an IFRS. It is also counter-intuitive to many to have different requirements for what seem to be similar transactions.

5. Inconsistent requirements between IFRSs can also cause tension between the two standards, encourage arbitrage between them, but more significantly might suggest directionally different applications of the Conceptual Framework, from which all IFRSs are developed.

6. However, there are occasions when the IASB in developing an IFRS will make a decision knowing that it is inconsistent with the requirements of other IFRSs. The reasons for this vary, but can include:

    - <u>Continuous improvement:</u> The IASB tends to undertake projects that focus on developing a new IFRS or improving an existing one; the focus is on one standard. The decisions the IASB takes on that project will aim to achieve an improvement in financial reporting in that area. Sometimes, in making those improvements, differences will be created with other, older IFRSs that are outside the scope of the new proposals. Taking a standard-by-standard approach means that improvements are more incremental and can be introduced more quickly than if all IFRSs were to be revised at the same time. A standard-by-standard approach can also make the development of new IFRSs more manageable for all; the IASB in developing the requirements, constituents in responding to proposals, preparers in implementing new requirements, and users learning about and adapting to the new information provided. The drawback is that inconsistencies might arise until such time as those other, older IFRSs are also revised.

    - <u>Context-specific decisions:</u> The IASB will make decisions that reflect the specific context of the project. Thus, for two projects being developed in parallel, the IASB might make different decisions because of the context of each project.

7. We had to deal with several cross-cutting issues when we developed the exposure drafts *Revenue from Contracts with Customers, Leases* and *Insurance Contracts*. Two examples are the accounting for contract acquisition costs and the use of discounting. These examples of cross-cutting issues are ones of which the Board was conscious of at the time it made decisions on these projects, but did so because it thought that different answers were appropriate.

Accounting for acquisition costs

8. The proposed guidance on accounting for acquisition costs for contracts in the scope of the revenue recognition project differs from that proposed for contracts in the scope of the insurance project and the leases project.

   (a) The proposed revenue recognition guidance requires costs associated with obtaining a contract to be expensed. A consequence of this approach is that a loss could be recognised on day 1 as a result of recognising costs as an expense (eg an incremental sales commission cost) if there is no revenue recognised in the same period.

   (b) The proposed insurance guidance also requires that acquisition costs are expensed. However the insurance liability, which reflects the obligation to perform, is measured taking account of the incremental acquisition costs. A consequence of this requirement is that no loss is recognised on day 1 as a result of incremental acquisition costs.

   (c) The proposed leases guidance requires lessors to include any initial direct costs in the initial measurement of their lease receivables. The costs are therefore reflected in profit or loss through a reduction in the interest income recognised on the lease receivable over the lease term. Lessees are required to capitalise incremental direct costs associated with entering the lease contract. Interestingly, the leases decision was to align the accounting with property, plant and equipment acquisitions as required by IAS 16 so that asset acquisitions and leases had the same requirements. Yet, in 2007 the Board wanted to amend IAS 16 to require such costs to be expensed. They wanted to do so because in developing the business combinations standard IFRS 3 the Board had decided that expensing acquisition costs was the appropriate treatment. The only reason the Board did not amend IAS 16 was because it had not exposed this consequential amendment. This example illustrates how inconsistencies can be perpetuated rather than eliminated over time—one Board cannot bind another Board.

Use of discounting

9. The revenue recognition project and the leasing project both refer to the calculation and specific reflection of time value of money. Determining when it is appropriate to reflect time value of money in measurement of assets and liabilities is normally a matter of judgement, based on an assessment of materiality. The IASB decided, based on the context of these two projects, to provide different requirements for the application of discounting. The proposed revenue recognition IFRS would require the time value of money to be accounted for when there is 'a material financing component' to the contract. The meaning of 'material financing component' is left to the discretion of those applying the IFRS. The proposed lease requirements, however, specifies that the time value of money need not be taken into account when the lease term is 12 months or less, thus leaving no room for judgement. Specifying different bases for determining when to reflect the time value of money would be perceived by many to be inconsistent.

Alternative approaches

10. Undertaking projects that focus on a single standard is common for the IASB. However, there have been a couple of projects recently that address cross cutting issues across several IFRSs. The first is the fair value measurement project and the second is the issue of credit risk on liability measurement.

11. The fair value project was taken on to develop a consistent approach and guidance to the measurement of fair value when an IFRS requires it. Currently several IFRSs require or permit the use of fair value in measurement and/or disclosure. Some of those IFRSs contain limited guidance on the measurement of fair value and others contain extensive guidance, but not necessarily consistent guidance. When finalised, the IFRS will provide, in one place, fair value measurement requirements that will clarify the definition of fair value, provide a clear framework for measuring fair value and enhance disclosures about fair value.

12. The IASB undertook a consultation on whether and how own credit risk should be reflected in liability measurement. This is an issue that cuts across several standards where a current measurement of a liability (including fair value) is required. The IASB decided, after considering the responses to the discussion paper published, to incorporate the topic into the Conceptual Framework project and meanwhile to consider the issue on a project-by-project basis.

Communication

13. The IASB's response to the cross-cutting issues identified in the development of the recent exposure drafts has been as follows:

- Cross-cutting issues have been identified and discussed by the IASB during its deliberations on the projects, on a cross-project basis.
- Reasons for decisions taken on cross-cutting issues in finalising the exposure drafts have been explained in the Basis for Conclusions to each exposure draft.
- The cross-cutting issues have been highlighted in the exposure drafts and specific questions on the appropriateness of the accounting proposed have been asked in each exposure draft.

Questions for Council members	
1.	Do Council members see other significant inconsistencies in IFRSs? a) What are those inconsistencies? b) Are any of the inconsistencies identified appropriate (i.e. the inconsistencies should be retained), and if yes, why? c) Do you think the IASB should address any of the cross-cutting issues you have identified? If yes, how? If no, why not?
2.	What advice do Council members have for the IASB on striking the balance between undertaking broad projects that can address cross-cutting issues, and narrower, in-depth projects that tackle focused financial reporting issues
3.	What advice do Council members have for the IASB on how the IASB could improve the way it communicates to and consults with constituents on cross-cutting issues?

Structure of small group sessions

14. Each Advisory Council member has been assigned to a sub-group in which they are asked to discuss the questions above. The sub-groups are asked to develop ideas that can be shared with the rest of the Advisory Council in the plenary session on Thursday morning.