

# OBSERVER NOTE

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AGENDA PAPER 2F

**To** David Sidwell, Chairman—Due Process Oversight Committee

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**From** Alan Teixeira, Director of Technical Activities  
+44 (20) 7246 6442 [ateixeira@ifrs.org](mailto:ateixeira@ifrs.org)

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**Subject** **General Update**

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This is a general update of matters relevant to the Due Process Oversight Committee, related to the development of IFRSs.

The update covers three areas:

- (a) Recently issued standards: some concerns have developed in relation to the endorsement process in Europe.
- (b) Forthcoming IFRSs and exposure drafts: an update on the four publications that were expected to be released by 30 June 2011.
- (c) The MoU projects: an update on deliberation plans.

Members of the Due Process Oversight Committee may wish to refer to the David Tweedie's report which provides a more detailed update on the status of projects.

## **Recently issued standards and exposure drafts**

### ***Amendments to IAS 1 and IAS 19***

On 16 June the Board issued amendments to IAS 1 *Presentation of Financial Statements* to improve the presentation of other comprehensive income and IAS 19 *Employee Benefits* mainly in relation to defined benefit plans.

Details of the feedback statements released were sent to the Committee on 17 June. We do not plan to issue any effect analyses for these amendments.

There are no matters that I am aware of that have changed since the last meeting of the Committee.

Having completed this phase of the project to revise IAS 19, and with any future phase still to be considered as part of the agenda consultation, it is an appropriate time to review the status of the Post-employment Benefits Working Group. My initial assessment is that we should identify a time to formally dissolve the working group. However, I am not proposing that we take this step now. There may be some benefit in keeping the working group together, albeit in a dormant state. Matters could arise as

part of any post-implementation that could benefit from the expertise of the committee. I think it would be helpful to have a clearer set of principles for when, and how, these working groups cease to exist. I will bring this matter back, more generally, at a future meeting.

### *Annual Improvements*

On 22 June the Board published a batch of Annual Improvements.

Before publishing the document the Board reconsidered the comment period. The Board decided not to have a comment period shorter than the normal 120 days. Accordingly, the comment period is the full 120 days.

As I noted in June, it might be appropriate in a future revision of the due process handbook to establish an alternative to the 120-day comment period for annual improvements, given that they must pass through strict criteria before they are included in the package. However, this matter is not urgent and does not, in my view, warrant a separate amendment to the due process handbook.

### ***The completion of IFRSs 10, 11, 12 and 13—an update***

In June I reported that the Board had issued, on 13 May 2011, IFRS 13 *Fair Value Measurement*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*. We released feedback statements for each of the new IFRSs on 13 May. Details of these Feedback Statements were sent to the Committee on 27 May. I also reported that we had drafted effect analyses for IFRS 10 and IFRS 11 which, at the time, I anticipated would be ready to give you in the first week of June. Unfortunately, drafting has taken longer than we anticipated. One of the main reasons is making sure that the documents meet, as far as possible, the needs of EFRAG and the European Commission, without compromising our own processes. We have been concerned, for example, about passing on detailed information that was supplied to us confidentially.

### **Forthcoming exposure draft**

#### *Investment Entities*

In July the Board is also planning to publish an exposure draft proposing to create an exception to consolidation for *Investment Entities*. Some jurisdictions, including Canada and the US, have special reporting requirements for entities that only invest in other entities and do not participate in the operation of any of the businesses that manage those investments.

The project objective is to define an investment entity and to require that an investment entity should not consolidate investments in entities that it controls, but to measure those investments at fair value, with changes in fair value recognised in profit or loss.

This exposure draft is part of the consolidations project and is being undertaken with the FASB. If finalised, the accounting requirements for such entities will be aligned.

In June I indicated that we would publish the exposure draft that month. However, it is a joint project with the FASB. The FASB will not be ready to release its version until about 22 July, because it is linking the release to a separate exposure draft on investment property companies.

The IASB has completed all of its formal voting requirements and is simply holding back the publication so that the two boards can release the proposals together.

The IASB exposure draft was supported by 12 Board members, with 3 Board members dissenting to the proposals.

I also noted in June that the Board has not published a discussion paper or established a working group for this project. The project focuses on a narrow set of entities and the accounting issues are well understood. However, it is a potentially controversial area because many jurisdictions considered but rejected this exception in their reporting requirements before they adopted IFRSs. The planned comment period is 120 days and the Board will hold round-table meetings after the comment period ends. These factors have not changed since my last report.

## **The MoU projects**

### ***Revenue recognition***

In June the boards decided to re-expose their revised proposals for a common revenue recognition standard. Re-exposing the revised proposals will provide interested parties with an opportunity to comment on revisions the boards have undertaken since the publication of an exposure draft on revenue recognition in June 2010.

It was the unanimous view of the boards that while there was no formal due process requirement to re-expose the proposals it was appropriate to go beyond established due process given the importance of the revenue number to all companies and the need to take all possible steps to avoid unintended consequences. Consequently, the boards intend to re-expose their work in the third quarter of 2011 for a comment period of 120 days.

The FASB is required to undertake fatal flaw reviews for exposure drafts. This will add to the project time line. Unfortunately, it is unlikely that the boards will be able to publish the exposure draft until September. Nevertheless, the work done now should reduce the review time required to finalise the proposals.

The exposure draft is likely to seek comments on four basic issues—it is a narrow scope re-exposure. However, it is inevitable that respondents will use this opportunity to renew discussion on some aspects of the proposals. For example, the proposals for the sale of handsets and their related contracts remain controversial. Board members

and staff are developing an outreach plan that will focus on this and other sensitive areas.

### ***Leasing***

The boards have made several decisions recently that simplify the models. For example, the original proposals for a ‘performance obligation’ model for lessors have been rejected by both boards. However, they have reached different decisions with the FASB preferring to retain the current approaches to lessor accounting and the IASB preferring a partial derecognition model. This matter was not resolved at the June Board meeting and is the main item to be discussed in relation to the project when the Board meets in July.

For lessees, the models have also been simplified. The boards have decided not to have two models for income recognition and are reverting back to the exposure draft proposals. However, boards have decided to offer relief from the accounting requirements for leases that are for a short term—12 months or less.

The Board is aware of the sensitivity of this project and the interest in whether the boards intend to re-expose the proposals. Even though the boards will still need to discuss some aspects of the project in September, the staff assessment is that the boards will have sufficient information to be able to assess re-exposure at the end of July. This will clarify any uncertainty in the minds of those using IFRSs.

### ***Effective dates—revenue, leases and financial instruments***

In July the boards will be considering effective dates. In particular, the staff will be recommending that the boards set a ‘not before’ date (likely to be 1 January 2015) to remove uncertainty from the market.

In a separate paper, the staff recommends that the IASB move the mandatory effective date for IFRS 9 *Financial instruments* from 1 January 2013 to 1 January 2015. The remaining chapters were expected to be finished by now, which is one of the factors the Board considered when it set the original date of 1 January 2013.

### ***Insurance contracts***

The insurance contracts project is not as well advanced as revenue recognition or leasing. Accordingly it will be around the beginning of the fourth quarter before we need to make decisions about the next due process document.

The boards have reached different decisions on a fundamental matter. The IASB has tentatively decided that the measurement of an insurance contract should contain an explicit adjustment for risk. The adjustment would be determined independently from the premium and would be remeasured in each reporting period. The FASB tentatively decided that an insurance contract measurement model should use a single margin approach.

The IASB faces two additional challenges. The IASB has already published an exposure draft whereas the FASB has only published a discussion paper. The boards will need to assess how best to align the timetables to increase the likelihood that the outcome will result in the same requirements. Although having our due process procedures out of step does not prevent us from developing high quality solutions, it does make it more difficult, as the fair value measurement project demonstrates. The other challenge is the relationship between the insurance contracts project and the financial instruments project. The IASB will need to ensure that the insurance contract standard and the financial instruments requirements (IFRS 9) work together.

### ***Financial instruments***

#### *Offsetting of financial assets and financial liabilities*

The IASB and FASB received 161 comment letters, a summary of which was presented to the boards at their public meeting in the week of 16 May. The boards have also held public round-table meetings in London, Norwalk and Singapore. The views expressed in the comment letters were mixed, mainly divided on geographical lines. As would be expected, those entities for which the proposed changes would have the most significant effect on their financial reports were not supportive of the proposals.

The boards have now considered the comments received. In June the IASB and FASB reached different conclusions—the IASB voted 15-0 to affirm the proposals whereas the FASB voted 4-3 not to proceed as proposed. The boards are examining ways to reconcile those differences.

#### *Impairment*

The boards received 212 comment letters, a summary of which was presented to the boards at their public meeting in April. Views were mixed, mainly split on geographical lines reflecting current practice.

The most common and consistent message we received was that the IASB and FASB must reach a common solution. In the public meeting in the week beginning 16 May the boards considered four alternatives:

- (a) finalise the approach developed by the IASB on the basis of deliberations before the convergence discussions (ie a time-proportional approach for a ‘good book’ and full lifetime expected losses for a ‘bad book’);
- (b) finalise the approach developed by the FASB based on deliberations before the convergence discussions (ie recognise losses expected to occur in the ‘foreseeable future’ period);
- (c) finalise the model in the Supplementary Document (published in January 2011) D taking into consideration feedback received; or

(d) develop a variation of the previous proposals, taking into account the feedback from the boards' original EDs and the supplementary document.

The boards decided to pursue the fourth alternative. A small working group of board members and senior staff from both the IASB and FASB has been created to develop some specific suggestions, such as baseline models or objectives. This group has developed suggestions to be presented to the boards within a reasonably short time.

The Board is aware that this phase of the project is a priority. The Board is also aware that developing another proposal that is not finalised undermines the credibility of the organisation.

#### *Hedge accounting*

The Board has continued to consider the views received from comment letters and outreach on the general hedge accounting model. The Board is working to finalise the amendments to IFRS 9 *Financial Instruments* in the second quarter of this year.

The Board has yet to consider whether re-exposure will be necessary. Over the next month we will assess whether we need to undertake additional outreach related to the drafting of the final requirements. At the time of writing this report we had yet to determine the extent of drafting outreach (a drafting review).

The Board resumed its public discussion of portfolio hedges in April and expects to develop further its proposals related to portfolio hedging before it finalises the more general hedging requirements. We therefore expect to publish an exposure draft for portfolio hedging later this year.