

Report of the IFRS Advisory Council Chairman

1. The IFRS Advisory Council met in London on 20-21 June. Most IASB members, as well as Hans Hoogervorst and Ian Mackintosh, and Messrs Glauber, DiPiazza and Goldschmid on behalf of the Trustees, attended some or all of the meeting.

General update by Chair and Vice-Chairs

2. Mr Cherry reported that the first quarterly reports based on IAS 34 are now being published by Canadian listed companies. The transition is going well although securities regulators have identified some deficiencies in disclosures.
3. Mr Macek reported that the recent annual IFRS forum in Indonesia attracted more than 300 participants from 21 countries. Topics included IFRS branding and adoption of IFRS rather than convergence. The next forum is in Bali. Other meetings are being organised in Asia-Oceania, including various AOSSG committees.
4. Mr Marteau reported on extensive outreach activities in Europe relating to the current IASB work programme (see the EFRAG report below).

Update on IASB Activities

5. Sir David reported on the major active projects. He noted that the IASB cannot cater to any single region and must balance the needs of all regions. Sir David took up the theme of regional representation. He noted that the IASB can receive say 20 different views from one region on how a proposed standard

This paper has been prepared by the IFRS Advisory Council of the IASB.

The views expressed in this paper are those of the authors.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretation Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

might impact that region, and that co-ordination of the views going to the IASB within the region, would make the comments more persuasive.

- (a) Revenue recognition: the boards will re-expose the revised proposed standard. The boards have also discussed issues raised by telecom companies with them and will not change the proposals as a result of these discussion.
- (b) Financial instruments: a revised 'three bucket' approach to loan loss provisioning is being considered, that builds on the previous proposals and is considered to be more operational. Hedge accounting and offsetting are still under discussion. The prospects of convergence on offsetting appear dim. The FASB favours an approach whereby offsetting would be permitted even if it is conditional on bankruptcy. The goal is to have the same effective date for all elements of the package of new and revised standards on financial instruments. The staff is recommending that the effective date be pushed back from 2013 to 2015 because of delays in finalising the package.
- (c) Leases: the discussion of lessee accounting is substantially complete. For accounting by lessors; the FASB prefers the approach in the current standard whereas the IASB prefers a partial derecognition approach. A 'working draft' of the final standard is expected in July. The decision whether to re-expose probably hinges on whether the partial derecognition approach is proposed for lessors.
- (d) Insurance contracts: the boards are much closer on major issues, including the discount rate and the treatment of the resultant volatility. A substantial staff draft is expected is by year-end. It is necessary to consider how the proposals dovetail with the proposals for financial instruments. The IASB has not yet decided on re-exposure.
- (e) Two exposure drafts will be published soon; one on 'Annual Improvements' with a 120-day comment period and the other on accounting by investment companies.

6. Comments of members included that:

- (a) Good progress has been made to date.

- (b) Revenue recognition is critically important. Re-exposure is welcomed.
- (c) A concern was expressed about one board issuing proposals ahead of the other. The risk is that further changes will occur when the second board catches up and is a disincentive to early adoption of the standard. If we want a joint standard, we should produce an ED together and then produce a final standard together.
- (d) The projects touch on fundamental issues. It is not always clear what principles are being adopted (eg risks and rewards or transfer of control). The Board should develop the concepts before dealing with details in individual standards.
- (e) First-time adopters are disadvantaged because IFRS 1 generally requires retrospective application, whereas some standards have prospective application.
- (f) The IASB should be more concerned with the needs of new countries adopting IFRSs.

EFRAG outreach activities

7. Outreach activities were conducted in eight locations by EFRAG and European national standard-setters in May on IASB projects on revenue recognition and leases. The report reflects the views of the participants and not those of EFRAG.
- (a) Revenue recognition: feedback was generally supportive. Several concerns were expressed, in particular that: with regard to disaggregation of contracts, revenue should not be recognised beyond the rights to consideration acquired; disclosures are excessive; and industry-specific information is needed to explain the business model.
 - (b) Leases: there was ‘massive rejection’ of the proposals. There was a unanimous view that not all leases were financing. A single approach for lessees cannot faithfully reflect the underlying economics. Participants preferred the current standard.

8. Comments of members included that:

- (a) The goal is comparability. A single approach reduces comparability.
- (b) Few users participated although there was an open invitation.
- (c) The larger issue in regard to outreach is the complexity of the concepts.
- (d) An IASB member expressed dismay and wondered whether the concerns on lease accounting related to specific industries. IASB outreach activities had shown broad acceptance of the proposals.
- (e) The Chair commended EFRAG and the European standard-setters for their efforts and encouraged others to undertake their own outreach. The feedback is valuable input to the IASB although care is obviously required to ensure widespread participation.

SEC update

- 9. Julie Erhardt reported that the Commission still expects to make a determination on IFRS for domestic issuers in 2011. The paper on a possible approach to adoption of IFRS is a staff paper and has not been deliberated by the Commissioners. SEC staff are also looking at financial statements using IFRSs and analysing differences with US GAAP to gain a better understanding of the potential impact for US issuers. Round tables will be held in July and a particular effort is being made to involve smaller issuers.
- 10. A member asked a question regarding the Commission's processes and Mr Goldschmid observed that in his experience it is unlikely a staff paper is issued if the Commissioners have fundamental objections to it.

Post-2011 agenda consultation

- 11. Hans Hoogervorst provided an overview of the draft consultation paper, which had been circulated to members on a confidential basis in advance of the meeting. The strategy must be sensitive to the needs of new areas using IFRSs such as Asia-Oceania and emerging markets. The Board had carefully considered the Council's advice, including that the paper should include a 'straw man' agenda, but feared such an approach might suggest that the Board had

already made up its mind. The draft paper takes both a ‘top down’ (developing versus maintaining) and ‘bottom up’ approach (eg constraining factors).

12. Comments of members included:

- (a) We need a sense of the total agenda, not just consulting on each project proposal individually. More detail on potential projects is needed. The consultation paper deals with topics on a one by one basis, and there is no overall plan of what needs to be looked at when over the next 5 and 10 year periods.
- (b) Is ‘business model’ now the driving force underpinning IASB decisions? If not, what underlying theme is moving us?
- (c) There is a risk of overextending ourselves. Concentrate on what is really important. There is a lot of ‘unfinished business’ on current projects that should be reflected in the plan, together with the need for a period of calm (‘stability of the system’).
- (d) We need a very clinical, intelligent look at the overall process of standard-setting. Why are there so many problems?
- (e) Timely completion of the conceptual framework project, including a disclosure framework, is very important. An analysis of the causes of bottlenecks in recent projects would be useful and would probably identify disagreement on conceptual issues as a major factor.
- (f) Impact assessments are very important.
- (g) Other comprehensive income (OCI) and recycling should be addressed as a conceptual issue, not just as a presentation issue.
- (h) More attention should be paid to regional needs and implementation issues.
- (i) Post-implementation reviews are critical.
- (j) It is important to integrate the agenda with the outcome of the overall strategy review.
- (k) The standards must be operational and practical.

13. The Chair observed that the comments made had not revealed any fundamental disagreement with the direction of the consultation paper. It would help respondents if the paper provided more information on the 'order of magnitude' of the various potential projects and activities.
14. Next steps: a feedback statement based on comments received will be published, probably in December. Agenda proposals will then be brought to the Council for discussion, probably in February 2012.

Advisory Council performance review

15. Charles Macek presented the final draft of the working group. He described it as being framed as an 'aspirational' proposal of goals and objectives. The document is not perfect and we will seek to improve it over time. Mr Macek noted that the paper tries to strike the right balance between strategic issues and technical advice. Council should not relinquish the technical aspects but the focus is intended to be more on conceptual and strategic issues. Suggestions were made to clarify and improve the drafting. Council unanimously approved the document, subject to final editorial review. The Chair thanked Mr Macek and the working group. The paper will be useful in evaluating and improving Council's performance. The challenge now is to implement the recommendations.
16. Next steps: the final draft will be posted for comment by members. The working group will then finalise it for issuance to members, the IASB and Trustees.

Translation

17. Judith Downes introduced the topic. Translation poses challenges in many countries and translation into various languages creates the risk of misunderstandings. Ken Creighton reviewed the IASB translation policy. The objective is to manage the translation process to achieve quality and consistency of translations. The goal is a single translation for each language.
18. Comments of members included that:

- (a) Having more than one translation in the same language is not ideal but the differences are relatively minor and do not pose a major problem.
- (b) Several members commended the efforts of the translation team.
- (c) The time required for translation and incorporation into local laws and regulations must be taken into consideration when setting effective dates. Early adoption of a new standard may not be possible until the translation process is complete, which creates inconsistencies among countries.
- (d) A literal 'word-for-word' translation may not always be appropriate because of differences in local customs and practices. An IASB member countered that literal translation is necessary to avoid differences in meaning. Mr Creighton replied that they consult a panel of experts to ensure the most appropriate terms are used. The objective is to convey the same meaning as the English version. The English text often uses long, complex sentence structures and numerous different terms are used rather loosely and interchangeably. This makes translation more difficult.
- (e) There may be a risk that the local legal version, translated as required by law, becomes the basis of any court case. However, if most people in the jurisdiction have used the English translation, the local translated version may not have been tested in the field.

19. Ms Downes concluded by noting that translation continues to be an important issue. No individual issue was identified that needs immediate consideration.

Cross-cutting issues

20. This was a follow-up from a discussion at a previous Council meeting. The concern is that certain issues that arise in more than one standard ('cross-cutting issues') are being dealt with in isolation and on an ad hoc basis. This creates the risk of inconsistent conclusions and inefficiencies arising from multiple debates of essentially the same issues. A member queried whether more recent standards supersede older ones dealing with the same issue, to which the answer is 'no'. The logical place to deal with cross-cutting issues, including

presentation issues, is in the conceptual framework. Members continue to give high priority to that project although it is recognised that the conceptual framework is not a panacea and cannot be expected to resolve all of the inconsistencies. Some inconsistencies may be warranted, in which case it is important to acknowledge the inconsistencies and explain the reasons for them.

21. Next steps: the Post-2011 agenda consultation will provide the opportunity to re-evaluate the conceptual framework project.

Use of underlying earnings and non-GAAP measures

22. The use of ‘underlying earnings’ and non-GAAP measures is occurring in jurisdictions that have adopted IFRSs. For example, adjustments are sometimes made for non-recurring items, non-cash items and non-core items but there are inconsistencies among companies and over time. Similar reporting practices occur in countries using national GAAP. Members observed that such reporting practices are not inherently bad and do not necessarily imply that IFRS is deficient. ‘Non-GAAP’ may be a misnomer because some of the measurements analyse the GAAP financial information. Pro-forma information giving details of acquisitions and disposals as of an earlier date is often very useful. It is up to regulators to decide whether to regulate such disclosures that are made outside the financial statements. The Board should concentrate on standards dealing with GAAP. It is not realistic for the Board to try to standardise non-GAAP measures as well. The IASB might conduct research into the nature and extent of the use of non-GAAP measures, but the purpose of the research would need to be carefully defined and it is not obvious what the Board would do with the results. Certain aspects of underlying earnings and non-GAAP measures might be dealt with in the conceptual framework project dealing with presentation. Post-implementation reviews could include consideration of whether a standard had had an effect on the use of non-GAAP measures.
23. The discussion was lively but inconclusive.
24. Next steps: the chair requested the Board and staff to reflect on the discussion and to provide some preliminary feedback. It might also be useful to consult the regulators for their views. The topic will be referred to the Agenda Committee.

Who is implementing IFRSs- and how? (IFRS 'branding')

25. Paul Pacter provided an overview on how IFRSs are being adopted in various countries. We are hampered by a lack of reliable data. The ideal is adoption of IFRSs as issued by the IASB. IAS 1 requires an unreserved statement of compliance with IFRSs but this disclosure is not always made and auditors are nonetheless issuing unreserved audit reports. Why is this happening? Enforcement of the standards is the responsibility of the regulators. Why are investors not asking for these disclosures? Moreover, even when a country does adopt IFRSs as issued by the IASB, comparability is impaired by different adoption dates, choices of accounting policies and 'residual tendencies' to retain practices adopted under old national GAAP.
26. Members generally agreed that the IASB must be aggressive in protecting the IFRS brand and guard against false claims of compliance of national standards with IFRSs when it falls short. A member suggested it would be helpful to users if audit reports made an explicit reference to compliance with IFRSs (in addition to compliance with national GAAP, where necessary). However, the IASB could gather and publish information on the extent to which national standards have, or have not, adopted IFRSs as issued by the IASB. The National Standard Setters group could assist in this exercise.
27. Next steps: staff will liaise with the National Standard Setters to seek their assistance. The NSS meet in September which may also allow us to bring this topic back to the Council meeting in October.

Monitoring Board review and Trustees' strategy review

28. Makoto Sonoda provided an update on the Monitoring Board review. He focused on the four questions directly related to the operations of the IFRS Foundation and the IASB. Four round tables were held. Approximately 80 comment letters were received and are posted on their website. The Monitoring Board expects to issue its final report in August in close coordination with the Trustees' strategy review. He reported that there is general support for the current three-tier governance structure.

29. Most respondents believe that the membership of the Monitoring Board should be confined to capital market regulators although there is some support for including prudential regulators, and regulators from emerging markets. Most respondents agreed with separating the role of IASB Chair and CEO.
30. Council members generally object to the Monitoring Board having influence on, or being able to add items to, the IASB agenda, because this might impair the IASB's independence.
31. There were also strong objections to the proposal that the Monitoring Board should have a larger role in the appointment of the IASB Chair.
32. Bob Glauber gave an overview of the Trustees' paper on setting the strategy for the second decade. This year is critical: we will move from the end of the convergence project with US GAAP; the US will expect to make a determination whether and how they will adopt IFRSs; and China, India and Japan are looking at what the US does. Mr Glauber identified three challenges: (1) some countries have not adopted IFRSs; (2) consistency of implementation in various jurisdictions; and (3) continuing to enhance the governance and oversight structure. The objective is to consolidate the gains to date and to plan for the second decade.
33. Comments arising from the break-out sessions included:
 - (a) The focus on investors as the primary users is appropriate, although the term needs to be defined broadly (eg equity and debt; short-term and long-term).
 - (b) The three-tier governance structure should be retained.
 - (c) The role of the Monitoring Board should be restricted to 'monitoring' the Trustees. We need to draw a clear line around the role of the Monitoring Board to avoid 'scope creep'.
 - (d) Trustees should have a more active and more transparent role in overseeing the IASB. The DPOC is very important in this regard and perhaps the Council has a role to play here.
 - (e) A levy is the preferred method of funding but each jurisdiction needs flexibility to put appropriate mechanisms in place. GDP is a good starting

point but might need adjustment for eg purchasing power parity. Private companies are another potential source of funding. The scope of the Trustees' review is not ambitious enough. It seems to be fine-tuning of where we are today and how to take it forward rather than asking fundamental questions about where we want to be. A wider review could potentially consider an ideal framework for a global standard setting body, and then worked towards identifying and closing gaps in the current position.

- (f) The IASB should be cautious in attempting to integrate XBRL with standard setting.
- (g) Separation of IASB staff and Foundation staff should be considered.
- (h) The independence and transparency of the IASB are critical.

34. The Chair concluded the session by remarking that the break-out groups had shown strong support for the direction that the Trustees are proposing. He commended the Monitoring Board and the Trustees for their efforts to collaborate and coordinate their reviews. The Council is willing and ready to assist the Trustees and the Monitoring Board.

Integrated reporting

35. David Phillips made a presentation on the work of the IIRC. He noted that integrated reporting is happening in the marketplace today although most reporting still focuses too much on financial information. The IIRC paper attempts to focus on the top-level structure for the whole reporting pyramid, providing a comprehensive view. A discussion paper is expected to be published in July for comment by October 2011.
36. Members commented that institutional investors are focused on financial measurements and seem to dismiss non-financial information. The director community is also likely to fear integrated reporting as another way of requiring more compliance. The challenge of promoting integrated reporting is to get institutional investors on board and address the concerns of the director community. Another member noted that the objective is not to produce less information but improve how it is presented. A Board member questioned

whether the dramatic increase in the length of prudential reports is necessarily a bad thing. How would integrated reporting improve things? Mr Phillips replied that the aim is more about making the information useful and insightful and making it more user-friendly.

The role of academic research in standard-setting

37. Holly Skaife conducted an education session on academic research and related methodology. Professor Skaife noted that a lot of academic research on IFRSs is being done, but the nature of the research is greatly influenced by the publication criteria of the major academic journals. Most academic research is inductive, not deductive, in nature. She provided a list of some of the relevant research. More information can be found at www.ssrn.com.
38. Members suggested that more deductive research dealing with basic concepts would be useful to standard-setters. Perhaps the IASB should establish an academic advisory council to foster research etc. It may be necessary to create incentives (eg funding) for academic research.