OBSERVER NOTE

IFRS FOUNDATION TRUSTEES
LONDON, 30 MARCH-1 APRIL 2011
AGENDA PAPER 7

IASB Chairman's Report

1. Six weeks ago I provided a comprehensive update of the activities of the Board over the last year as well as an outline of how we are planning to complete the major financial crisis related and MoU projects—financial instruments, revenue recognition, leases and insurance. The February update is attached as an appendix to this report.

2. This paper summarises the main changes to that report since February, including an updated assessment of the MoU projects.

3. As I reported in February, the Board has been focusing almost exclusively on four main projects. We have increased significantly the number of public Board meetings, most of which are being held jointly with the FASB. For example, this month the two boards will meet in four of the five weeks for a total of over 65 hours of public discussions.

4. We would not have been able to undertake such an intensive period of debate if it had not been for the commitment of our technical staff. They continue to respond to the considerable pressure under which they have been placed and they remain focused on completing the projects in line with the internationally-supported target dates. Those target dates are essential to maintaining that focus. We cannot expect our staff to sustain this effort indefinitely. Unnecessary delays to the projects would have a detrimental effect on staff morale.

5. Although 30 June 2011 remains important, quality remains paramount. The Board will not issue a new IFRS unless it is confident that it is of high quality. To help give the Board that assurance, staff and members of both boards have been undertaking additional fieldwork in those sectors most affected by the proposed new requirements. The boards will consider the feedback that they receive from this fieldwork before either board finalises any of the proposals.

Forthcoming publications

Consolidations, joint arrangements and structured entities

6. Having completed all its deliberations, the Board is in the process of completing its formal voting processes on what will become IFRS 10 *Consolidated Financial Statements*, which we will issue in conjunction with IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*. We expect to issue the new standards in the next few weeks.

7. Among the improvements that this package of new standards will bring are new disclosure requirements relating to structured entities (special purpose entities). These new disclosure requirements respond to requests from the Financial Stability Board.

8. The standards will be mandatory for annual periods beginning on or after 1 January 2013, although entities will be allowed to apply the new requirements earlier if they wish.

9. We recently discussed these documents with the Due Process Oversight Committee as part of its enhanced engagement. At that meeting we outlined the steps that the Board has taken to ensure that the development of these new requirements met, and in fact exceeded, the Board's due process requirements.

Post-employment benefits and other comprehensive income

10. Having completed all its deliberations, the Board is in the process of completing its formal voting processes to amend IAS 19 *Employee Benefits*. Like recent amendments to US GAAP, the amendments will improve reporting by eliminating provisions that permit off balance sheet reporting of post-employment benefit obligations. At the same time, we will be amending IAS 1 *Presentation of Financial Statements* to improve how components of 'other comprehensive income' are presented. The FASB is making similar, but more extensive, changes to its requirements to bring its reporting into line with IFRSs.

11. The Board expects to issue the amendments to IAS 19 before the end of April. The changes to the reporting of post-employment benefits will be mandatory for

annual periods beginning on or after 1 January 2013. The changes to the reporting of other comprehensive income take effect on 1 January 2012.

Fair value measurement

12. The Board has also completed its discussions relating to fair value measurement and in April it will issue what will become IFRS 13 *Fair Value Measurement.* The result will be that the definitions of fair value will be the same in both IFRS and US GAAP. The IFRS (and US GAAP) will also provide guidance on measuring fair value when markets are illiquid. IFRS 13 will not, and the FASB standard did not, introduce any new requirements about when to use fair value. The fair value standards are concerned only with how to measure fair value when it is required by an IFRS. IFRS 13 will have an effective date of 1 January 2013.

The financial crisis and MoU projects

The financial crisis projects

Classification and measurement

13. IFRS 9 *Financial Instruments* is being developed in phases. The classification and measurement and derecognition requirements are already used in many jurisdictions. However, we continue to receive requests, particularly from some European organisations, to reopen aspects of IFRS 9. In particular, some parties would like the IASB to consider reintroducing bifurcation of financial assets and reintroducing some notion of ‘available-for-sale’ financial assets. On the other hand, many organisations, including some European ones, have told us *not* to reopen the classification and measurement parts of IFRS 9.

14. We will continue to receive these competing pressures until the FASB has finished its deliberations on classification and measurement. The FASB has already stated publicly that it believes that amortised cost is an appropriate measurement basis for some financial instruments. However, the FASB has still to determine how many classification categories it will require or whether it will retain its existing bifurcation rules.

15. Once the FASB has made its decisions about classification and measurement, the IASB will expose the FASB's final conclusions to seek views on whether the Board will need to consider how, or indeed if, it should bridge or reconcile any differences between IFRS 9 and US GAAP. Any such assessment now would be premature because it would be based only on speculation about what the FASB's decision might be.

Impairment

16. In late January the Board published, jointly with the FASB, a supplement to the December 2009 exposure draft,. The supplement presents an impairment model that the boards believe will enable them to satisfy at least part of their individual objectives for impairment accounting while achieving a common solution to impairment. The comment period closes on 1 April.

17. Our initial feedback from outreach activities elicited a mixed response. Many would prefer the IASB's simplified proposals—seeing the addition of a floor as a complication. Others prefer aspects of the US model. The boards will be discussing the project in public in the coming weeks. The objective remains to complete this phase by 30 June 2011.

Hedge accounting

18. On 9 December 2010 the Board published proposals to revise hedge accounting, for both financial and non-financial exposures. Comments were due by 9 March. During the comment period, staff and Board members undertook outreach activities in six continents, meeting over 2,500 people in small group meetings and discussion forums. The Board received 233 comment letters, a summary of which was presented to the Board on 16 March.

19. There was strong support for the proposals, with respondents welcoming the Board's approach to address hedge accounting comprehensively. They also agree with the principle-based approach proposed in the exposure draft, with many commenting that they thought the proposal would resolve many of today's practice problems in applying IAS 39 *Financial Instruments: Recognition and Measurement*.

20. The exposure draft published in December was concerned with general hedge accounting. It did not address portfolio hedges. In February an expert in financial instruments on secondment from a major accounting firm joined the hedge accounting team, to work on proposals for portfolio hedges. The Board expects to resume its public discussion of portfolio hedges in April and expects to develop 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.

Balance sheet netting of derivatives and other financial instruments

21. In late January the boards published a joint exposure draft proposing changes to IFRS and US GAAP that would align the reporting of offsetting financial assets and liabilities. Comments are due by 28 April. Feedback from our outreach indicates that there is broad support for our proposals in those jurisdictions that are applying or moving to IFRSs. The feedback from those that currently apply US GAAP is mixed, with many saying that they would prefer us to allow more netting (which would be closer to current US GAAP). The project itself is not difficult from a technical accounting perspective, but the financial reporting consequences of reaching a shared solution with the FASB will be significant for many entities.

Revenue recognition, leases and insurance contracts

22. In addition to the financial crisis-related projects, the Board is working on three major projects. Revenue recognition and leases are MoU projects being developed jointly with the FASB. Insurance contracts is not in the MoU, but the IASB has been working with the FASB with the goal of developing common requirements.

Revenue recognition

23. The Board has now considered most of the significant issues in this project and confirmed the basic elements of the proposals. That is not to say that the Board is not making changes to the proposals. The IFRS will explain more clearly the principles that are fundamental to the revenue recognition model, to ensure that

the standard will be capable of being applied consistently across a wide range of contracts. The sectors most affected by the proposals include the construction industry, pharmaceuticals (contingent consideration), and telecommunications. We have undertaken additional fieldwork in each of those sectors.

24. The project is critical to both the US and the IASB. US GAAP has a wide range of very detailed industry-specific requirements that are widely acknowledged as being inconsistent. The IASB has very general requirements that cause preparers to rely on US GAAP for specific guidance. The project is intended to reduce the FASB's detailed guidance to consistent principles and to remove the need for IFRS users to refer to US GAAP.

Leases

25. By the end of April the Board will have considered all of the major issues in the project. Our main focus has been on ensuring that the definition of a lease does not catch what are widely perceived to be service agreements. What remains important is that, for a lessee, the assets that they control as a result of the lease agreements, and also the related lease obligations, are recognised and presented in the statement of financial position.

26. We are assessing the feasibility of modifying the pattern of income and expense recognition for some leased assets—those for which the lease payments include premiums that give the lessee some operating flexibility. We remain confident that there are credible solutions to the concerns that have been raised, including those concerning contingent rentals and renewal options. The staff and Board members have already begun intensive fieldwork related to these matters.

27. We expect to consider lessor accounting over the next few weeks.

Insurance contracts

28. As with the other major projects, the Board will, by the end of April, have considered the main issues in the project.

29. For the issues considered so far, the IASB and FASB have reached the same decisions on all of the important matters. The boards have reached different conclusions on some matters, but we will return to those items again with the goal of developing common solutions. The most challenging issues are

specifying the discount rate and income statement volatility. The Insurance Working Group is meeting with board members and staff from both boards in the week of 21 March to discuss the decisions reached so far.

30. There are two other 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 so that the outcome is identical final standards.

31. 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 IFRS and the financial instruments requirements (IFRS 9) work together. The FASB will have the same challenge as it finishes its own financial instruments project.

Other projects

Financial statement presentation

32. Last year the IASB and FASB decided to hold back the publication of an exposure draft for the financial statement presentation project until the boards had undertaken additional outreach to enable the boards to assess the feasibility of completing the project in its current form. We completed that exercise in December, having held discussion forums and face-to-face meetings with many interested parties. The Board is very grateful to all of the entities and individuals who provided us with feedback.

33. In February the staff presented a summary of what we had learned from the outreach. It is clear that there was broad support for some aspects of the proposals, which would have reshaped the basic financial statements, but not for the package as a whole. Many participants in the outreach suggested that we should consider continuing with some parts of the proposals. At the same time they urged us to consider expanding the scope of the project to address what should be reported in *other comprehensive income*. The Board will consider the project again as it develops its new agenda. The relative merits of continuing with a modified form of the project will be assessed against other agenda requests.

Other matters

Effective dates and transition

34. In October last year we published, with the FASB, a *Request for Views* seeking views on ways in which we could reduce the costs of applying new requirements. Our consultation focused on the effective dates of new requirements, whether early adoption should be permitted and transition.

35. Comments were due by the end of January. We received 149 comment letters. The staff presented a summary of the comments to the Board in February. The separate consultation on effective dates was very well received. The initial analysis suggests that many entities and users would prefer longer than usual to prepare for mandatory adoption of the revenue, leases and insurance contracts standards—1 January 2015 was a common suggestion. We will consider effective dates, transition and early adoption (which was generally supported) in April.

Future agenda

36. The Board is finalising a *Request for Views* on the future agenda of the IASB. We discussed a draft with the IFRS Advisory Council at its February meeting and have reflected many of their suggestions in the document. We have delayed publication to reduce any overlap of the comment period with standards-level exposure drafts and to provide the trustees, the Advisory Council and the incoming Chairman and Vice-Chairman of the IASB with the opportunity to contribute to the development of the consultation paper.