AGENDA PAPER

IFRS Foundation Trustees meeting

London | 13 April 2012 | Agenda ref 2

Memorandum

To: IFRS Foundation Trustees

From: Hans Hoogervorst

Date: 26 March 2012

Re: Report of the IASB Chair

Overview

Since the Trustees last met in January 2012, the IASB has:

- Published amendments to IFRS 1 *First Time Adoption of International Financial Reporting Standards* to address accounting for government loans.
- Held round tables and commenced discussions of feedback received on its first formal public agenda consultation.
- Continued discussions on the format of our post implementation review process with specific focus on IFRS 8 *Segment Reporting*.
- Held round-tables with the FASB on the proposals for investment entities. Round tables were held in February and March in Canada, the UK, the US and Malaysia.

Accompanying this report you will find a copy of the work plan, as at 13 March 2012, and a more detailed analysis of the work we have been undertaking this year.

Completing the MoU projects

Through much of 2010 and the first half of 2011 the focus of the IASB was on the successful completion of four projects by the end of 2011—the three remaining projects on the IASB-FASB MoU (financial instruments, leasing, and revenue recognition) and insurance contracts. However, by July 2011 it became clear that these projects would not be completed in 2011.

We have had difficulties reaching converged solutions with the FASB on financial instruments and insurance. We hope to finalise deliberations on joint proposals on impairment accounting in the first half of 2012. In January 2012 we decided to jointly redeliberate selected aspects of our financial instruments classification and measurement models to seek to reduce key differences. We also hope to finalise these deliberations in the first half of 2012.

We have already re-exposed revenue recognition and agreed to re-expose the leases proposals. While formal decisions have not been made, we anticipate that classification and measurement and impairment will be re-exposed. Like any exposure draft (ED), on re-exposure these EDs will include a full Basis for Conclusions and relevant application guidance and illustrative examples.

Delays in completing these much needed improvements to financial reporting for those using IFRSs and US GAAP are unfortunate, but they should not be seen as a failure. They reflect the IASB being cautious, responsive and responsible. It is incumbent on the Board to ensure that changes made to our accounting requirements are appropriate and that our stakeholders have had the opportunity to fully participate in the process. Re-exposure, in this case, is part of that process.

In the next sections I provide a brief summary of the developments in these and other projects.

Financial Instruments

IFRS 9 – Classification and Measurement

Limited modifications to IFRS 9

The classification and measurement chapters of the new financial instruments standard, IFRS 9, were completed in 2009 (financial assets) and 2010 (liabilities). While the FASB has now also tentatively decided on a mixed measurement model for financial instruments, they have reached different answers from the IASB model on matters such as the number of classification categories, which assets should be measured at fair value, where fair value changes should be recognised and the bifurcation of embedded derivatives. In addition there are important legacy differences, such as whether items measured through OCI should be recycled to net income when they are sold.

The two boards cannot avoid facing these differences. The IASB and the FASB have consistently received feedback from stakeholders that every effort should be made to make their respective financial instruments accounting standards converge.

In addition, many insurance companies have requested that we consider changes to the accounting for financial assets to assist them in properly reflecting their business models.

However, some entities are already applying IFRS 9 and others have made a considerable investment in anticipation of moving to IFRS 9. We are aware of the tensions between considering changes to IFRS 9, giving users of IFRSs stability and certainty and the need to ensure that the accounting for financial instruments is of the highest quality.

In November 2011 the Board agreed to consider modifying IFRS 9 particularly in view of convergence and the insurance contracts project. However the Board noted that any changes should be made in a manner that minimises disruption for those who have already started to apply or were close to applying IFRS 9. The Board also noted that IFRS 9 is fundamentally sound and that the project should be completed expeditiously.

In December 2011, the Board tentatively decided to limit the items to be reconsidered to the contractual cash flow characteristics criteria, whether bifurcation for financial assets should be reconsidered and whether an OCI remeasurement should be used for some debt instruments.

In January 2012 the IASB and the FASB decided to jointly redeliberate these items and any knock-on effects (for example, disclosures or the model for financial liabilities in the light of the financial asset decisions). The boards plan to discuss each of these issues jointly and to consider the effect of any changes on their separate models.

A formal decision on re-exposure has not yet been taken but the boards are currently targeting publishing proposals in the second half of 2012.

Impairment

The objective of the impairment project is to increase the usefulness of financial statements by improving the transparency of information about the credit quality of financial assets. The main focus is the estimation and reporting of expected losses in a timely manner. This phase of the project is being developed jointly with the FASB.

In November 2009 the IASB published for public comment an exposure draft on impairment accounting. The proposals followed an initial *Request for Information*, published in June 2009, on the practicalities of moving to an expected loss model. Recognising the significant practical challenges of moving to an expected loss model, the IASB established an Expert Advisory Panel (EAP) in December 2009 that was made up of experts in credit risk management.

In January 2011 the IASB published, jointly with the FASB, a supplement to the December 2009 exposure draft. There was limited support for the proposals in the supplementary document.

Since then, the IASB and the FASB have focused on an approach that places financial assets into three categories (or 'buckets') for the purpose of assessing expected losses. The impairment allowance recognised would vary depending on which category an asset is allocated to. Generally 12 months of exposed losses are recognised on initial recognition.

Then if an asset deteriorates in credit quality and the credit quality is below a certain level it would be reclassified to another category and a lifetime loss allowance would be recognised.

This project is of the highest importance and reaching a converged solution is also paramount. We are aware of the importance of finalising the impairment project expeditiously as impairment accounting has been a primary area of concern during the financial crisis. However, impairment accounting has major cost and systems implications, particularly for financial institutions so we need to balance the need for timely completion against the importance of obtaining robust input from our constituents. The boards have been consulting widely with, among others, prudential supervisors and members of the IASB's Expert Advisory Panel of credit risk experts who provide guidance on the operational considerations of proposals.

The boards are working towards publishing a joint proposal for comment in the second half of 2012.

Hedge accounting

The general model

In September 2011 the Board completed its deliberations of the general hedge accounting project and asked the staff to prepare a review draft of the final requirements, including application guidance and a Basis for Conclusions. The review draft will be made available on the IASB website for about 90 days. We expect this document to be published early in the second quarter of 2012. The Board plans to finalise the general hedge accounting requirements once this review is complete. The review draft will provide the Board with the opportunity to undertake an extended fatal flaw process and additional outreach. The Board also wishes to give the FASB the opportunity to consider the planned requirements.

The Board has not yet completed its formal review of its due process steps. It will do so once the staff have completed the drafting review (ie after the 90 day period) and reported back to the Board. Then the Board will review its due process steps and will assess whether re-exposure is necessary.

The hedge accounting phase of the financial instruments project is not a joint project. However, the FASB sought comments from its constituents on the IASB's hedge accounting exposure draft that it will consider in conjunction with feedback on its own proposals when they recommence their hedge accounting deliberations.

The macro hedge accounting model

The Board resumed its public discussion of portfolio hedges in April 2011. The Board expects to publish a discussion paper or exposure draft during 2012. The model being explored by the Board is very different to the current hedge accounting model so the Board is likely to decide to issue a discussion paper rather than an exposure draft.

Leases

Lease obligations are widely considered to be a significant source of off balance sheet financing. The objective of the leases project is to improve financial reporting by lessors and lessees.

The boards published a joint exposure draft in August 2010. During 2011 and 2012 the IASB and FASB have been considering the comments received.

In July 2011 the boards decided that, although they had not completed all of their deliberations, they had sufficient information to be able to conclude that they would re-expose the proposals.

Although the boards have addressed many of the issues raised by respondents to the exposure draft we are aware of some remaining concerns about whether all leases should be accounted for in the same way. For example, to achieve a straight line profit and loss expense some have questioned whether the lessee accounting for real estate leases should be different to the proposed model. While the redeliberations are substantially complete, the boards are reconsidering the appropriate profit and loss profile for lessees in light of feedback already received (ie prior to publishing the new exposure draft).

In January 2012 the leases working group was convened to discuss this issue. At the February 2012 meeting, the boards used the input received from the working group to further discuss lessee accounting and, in particular, different methods of amortising the right-of-use asset recognised by lessees. The boards asked the staff to perform further outreach on those different methods to assess their operationality and usefulness for users of financial statements. The staff will report back to the boards in the second quarter of 2012.

The expected timing of publication of the re-exposure document is the second half of 2012. The Board has not yet formally decided on the comment period, but the staff recommend a 120-day comment period.

Revenue recognition

This is a joint project with the FASB. As I have previously reported, the boards re-exposed their revised proposals. 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. Therefore, the boards have now issued three due process documents: a discussion paper in December 2008, an exposure draft in June 2010 and a revised exposure draft in November 2011.

The revised exposure draft was published on 14 November 2011 with a comment letter period of 120 days that ended on 13 March 2012.

The revised exposure draft focussed on key areas with the boards limiting their request for responses to six questions.

Before publication, a diverse range of outreach was conducted to raise awareness of the boards' proposals and to discuss their implications with interested parties. This outreach continued throughout the comment letter period.

The boards intend to hold public discussions on their proposals in May 2012 in London, Norwalk and Tokyo and additional outreach meetings in South America and Malaysia. The boards expect to complete redeliberations in 2012.

Other Projects

Insurance contracts

The boards are working together on the insurance contracts project but have reached different decisions on several basic matters. In addition, the IASB has already published an exposure draft, whereas the FASB has only published a discussion paper. The boards are assessing how best to address these differences and how to align the timetables to best ensure that the outcome is final standards that achieve the same outcomes as far as possible.

The other challenge is the relationship between the insurance contracts project and the financial instruments project. We have always made it clear that the IASB will need to ensure that the insurance contract standard and the financial instruments requirements (IFRS 9) work together. As noted above, limited modifications to IFRS 9 are now being considered. This will also aim to address specific concerns that have arisen from stakeholders in the insurance contracts project relating to volatility in profit or loss.

In June the boards were planning to publish the next due process documents for insurance by the end of 2011. This is now not expected to happen until at least the second half of 2012. It has not been formally decided if the IASB will publish an exposure draft or a review draft.

Consolidation

In December 2011 the Board published a very short exposure draft to clarify the transition requirements for IFRS 10 *Consolidated Financial Statements*. This is expected to allay fears by confirming the extent of relief provided on transition which some had misunderstood as being more narrow than the Board intended. Given its length, the fact that the clarifications benefit preparers and thus should be well received and the fact that the mandatory effective date of IFRS 10 is 1 January 2013, a 90 day comment period was provided. The DPOC was consulted before the exposure period was set. The comment period ended on 21 March 2012. In April 2012 the Board expects to start its redeliberations based on the feedback received.

The Board received a request from EFRAG for deferral of the effective date of IFRS 10, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*. The Board discussed this request and noted that IFRS 12 in particular was an important financial crisis related project and that others (including some European constituents) did not feel deferral was appropriate given the resources committed to timely application. On balance the Board decided not to defer the mandatory effective date.

Investment entities

In August 2011the IASB published a proposal that would require investment entities (as defined) to measure investment in controlled entities at fair value through profit or loss (rather than consolidating such investments). In October 2011 the FASB published similar proposals. The comment period on the IASB ED ended on 5 January 2012 and on the FASB one on 15 February 2012. Joint round-tables are being held in the UK, the US, Canada, and Malaysia. Redeliberations will commence in April 2012.

Amendments to IFRS 1

On 13 March 2012 the IASB issued amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

The amendments add an exception to the retrospective application of IFRSs to require that first-time adopters apply the requirements in IFRS 9 *Financial Instruments* and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* prospectively to government loans existing at the date of transition to IFRSs.

This means that first-time adopters shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant. However, entities may choose to apply the requirements of IFRS 9 and IAS 20 to government loans retrospectively if the information needed to do so had been obtained at the time of initially accounting for that loan. These amendments give first-time adopters the same relief as existing preparers of IFRS financial statements.

Entities are required to apply these amendments for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Agenda Consultation

On 26 July 2011 the IASB launched its first formal public agenda consultation on its future work plan. Comments were requested by 30 November 2011. Through the agenda consultation the IASB is seeking input from all interested parties on its strategic direction and the broad overall balance of the work plan. The agenda consultation will provide the Board with important input when considering possible agenda items.

In January 2012 the Board discussed the staff's summary of feedback received on the agenda consultation. The feedback reported to the Board was developed on the basis of the 245 comment letters received, the results of an on-line survey of investors and feedback received from outreach activities undertaken by Board members and staff members. These papers were also presented to the Advisory Council at their February 2012 meeting.

The staff did not make any recommendations and the Board was not asked to make any technical decisions. The Board requested that the staff should do further research to clarify some matters raised in the comment letters and suggested further ways in which the priorities for standards-level projects could be assessed. The Board expects to discuss a development plan in the second quarter of 2012.

Post Implementation Reviews

At the March 2012 Board meeting the Board received a report and agreed on the plan for the post implementation review of IFRS 8. (Please see Agenda paper 3D).