AGENDA PAPER

IFRS Foundation Trustees' meeting—Due Process Oversight Committee

Washington DC	11 July 2012	**Agenda ref**	**4Gi**

DPOC: Correspondence with Michael Straut

The papers for this agenda item are attached as follows:

i. Staff report to the DPOC

ii. Mr Straut's original e-mail of 18 December

AGENDA PAPER

IFRS Foundation Trustees' meeting—Due Process Oversight Committee

Washington DC	11 July 2012	Agenda paper 4Gi

To: Due Process Oversight Committee

From: Alan Teixeira

Date: 29 June 2012

Re: **Correspondence: Response to an email from Michael Straut**

Background

In December 2011 Michael Straut sent an email to the DPOC expressing concerns about how the IASB was developing IFRS 9 Financial Instruments in phases. We did not receive clearance from Mr Straut to make his complaint public until April 2012, which is the reason for the delay in bringing this matter to the DPOC.

Complaint

The basic complaint is that revisions to IFRS 9 make it difficult for users, preparers and auditors to plan for and apply the requirements. Mr Straut acknowledges that developing Standards in phases is not the normal practice of the IASB but we should have anticipated that earlier phases of IFRS 9 might need to change as later phases were completed. Also, he notes that we identified the interrelationship with the Insurance Contracts project so should have delayed finalising the first phase of IFRS 9 until those relationships had been addressed.

Mr Straut has suggested that procedures should be introduced to ensure that when a Standard is developed in phases that interact with each other they should be completed together.

Response

The IASB was aware of the risks associated with developing IFRS 9 in phases when it developed its project plan. The relationship with Insurance Contracts and the relationships between the different phases of IFRS 9 were known. However, the IASB's work programme and priorities was influenced by requests from the Financial Stability Board (FSB), the G20 and the EU to make significant improvements to the classification and measurement of financial instruments by the end of 2009. The IASB did so, with an unprecedented amount of outreach. The IASB was very open about the process it was following. The Trustees monitored these developments closely and supported the way the IASB was developing IFRS 9.

The IASB is aware that phased development is not optimal. However, the IASB must also decide if developing a project in phases will lead to significant improvements in financial reporting sooner than could be achieved by waiting for all phases to be completed.

I am satisfied that the IASB considered these factors, was transparent about how it would develop IFRS 9, including making interested parties aware that changes to the first phase might be necessary when the Insurance Contracts project was more advanced.

From: Michael Straut
Sent: 18 December 2011 07:36
To: dpoc
Subject: IFRS 9 Financial Instrument

Respected Mr. David Sidwell – Chair of Due Process Oversight Committee,

Hope you are doing fine. I am writing to bring to your notice concern I have over IFRS 9 "Financial Instrument" and the imminent changes / potential changes which IASB is currently contemplating. As a user / preparer / auditor of financial statements or even academic fellow one would like to have certainty that the Standard that has been issued would remain valid at least for considerable period of time so that one could understand and being educated on the principles embodied in Standard. However, when principles established in Standard itself considered being moving target / moving goal post, it creates doubt over the effectiveness over the process undertaken for creation of principle in the Standard first place or even the robustness or rigor of the standard setting process and made skeptic of the ability of the Board in providing robust framework for preparers/users/auditors of the financial statements. I understand and acknowledge that when IASB has pronounced / issued IFRS 9 it has stated that later it may consider the model developed by FASB and will expose for public comments to see if any principles used by FASB could be made part of IFRS 9 or even IFRS 9 could be further simplified. But I believe it should have not been envisaged that it may be considered before the standard itself become effective. Recently IASB has deferred the effective date of IFRS 9 owing to delay in other financial instrument phase i.e. impairment and insurance project, it all add more uncertainty among preparers/users/auditors / academic fellow and add more doubt over effectiveness of standard setting process. Doing standard in phases is not of typical for IASB, however, before making standard effective IASB should have envisaged the interaction and may have adopted an approach whereby a model for classification and measurement could have been finalized in working draft form without enforcing it and should have issued Standard when all phases have been finalized so that the users/ preparers/auditors/academic fellow could have seen the entire model rather see one phase completed which in of itself is subject to change. Further I believe the Board Members were aware of the interaction of financial instrument project with insurance project and could have delayed the announcement of IFRS 9 in phases till it has finalized insurance project. Now after introducing the criteria for classification and measurement the Board has stated to see if any accommodation could have been made for insurance project by introducing OCI for debt securities i.e. third business model and it also require Board to formulate principles for impairment as well and also put a question for recycling along with reopening of recycling of gains or losses for equity instrument. One other project where Board so far has understood the interrelatedness and seems work perfectly was around Revenue, lease and Insurance. The Board has ensured the consistency wherever it could have been made. However, it fails to achieve in financial instrument project. All of these uncertainties have created frustration and lose the appetite among preparers/users/auditors or even academic fellow in gaining understanding of principles in IFRS 9 which they believe would change in near term. The Board Members have maintained that the principles in IFRS 9 are sound and workable but at the same time indicating that they will consider changing the business model currently contained in IFRS 9 by introducing third business model. I really question the benefit IASB has achieved in pronouncing classification and measurement principles for financial assets and financial liabilities when they intend to change. They could safely have delayed without first providing standard and later change it without letting it become effective and applied in practice. Though I understand that Board intend to make any changes to IFRS 9 as minimum as possible and would not change the fundamentals of the model, but it not doing any good to users/preparers/auditors or even academic fellow as many are skeptic and believe that it would end in change that would require them to start the understanding process from scratch since introducing third business model could not be achieved without tweaking the criteria which currently have for amortized cost. It also leads me to question whether the complexity in accounting for financial instruments has been really reduced (though the subject is itself complex which could only be reduced and can't be eliminated).

From Due process perspective I believe a provision or procedures should have been introduced whereby a principles / framework could be provided to the Board where development of Standard is taken in phases with all phases have an interaction with each other so that the issues as occurred in financial instrument could have been avoided.

Thanks & Regards
Michael Straut