

Summary of Global Preparers Forum and Capital Markets Advisory Committee Meeting

This is a summary of the topics discussed at the Global Preparers Forum and Capital Markets Advisory Committee meeting on 20 June 2012 prepared by the staff of the IFRS Foundation. For more detailed information about the meeting, please visit <http://www.ifrs.org/Meetings/CMAC+meeting+June+2012.htm>

Introduction

1. The Capital Markets Advisory Committee (CMAC, formerly the Analyst Representative Group) and the Global Preparers Forum (GPF) held a meeting in London on 20 June 2012. Four IASB members and some staff were in attendance. Prabhakar Kalavacherla, IASB member, welcomed the GPF and CMAC members. After that, Koushik Chatterjee, Angelica Ferreira, Martijn Bos and Mark Prentice who had not previously attended a GPF or CMAC meeting, provided the group with some information about their professional backgrounds.

Work Plan Update

2. Peter Clark, the IASB's Director of Research, gave an update on the IASB work plan. He described the current activities of the hedge accounting, insurance contracts and investment entities projects. He also discussed:
 - (a) the Board's discussions on the disclosure requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* regarding the effect of standards that have not yet become mandatory;
 - (b) annual improvements projects; and
 - (c) amendments to the transition requirements in IFRS 10 *Consolidated Financial Statements*.
3. A GPF member asked about feedback from the June IFRS Advisory Council meeting in respect of the agenda. Ian Mackintosh, Vice-Chairman of the IASB, replied that there was a lot of consensus regarding the agenda. He also stated that the IASB will start working on the Conceptual Framework again.

4. GPF and CMAC members asked about the status of the SEC report regarding the adoption of IFRS in the US. Ian Mackintosh said the SEC is waiting for a staff paper discussing IFRSs; however, it was expected that the paper would not include any recommendations regarding the use of IFRSs in the US. He said that there is uncertainty about when the SEC will make a decision regarding the use of IFRSs in the US.
5. A GPF member asked how the use of IFRSs in the US would affect the IASB agenda consultation. Mr Mackintosh replied that after the four main joint projects are completed, the convergence project between the IASB and the Financial Accounting Standards Board (FASB) will be finished. He also clarified that further work on the Conceptual Framework will not be a joint project with the FASB, though the IASB would seek to involve national standard setters, including the FASB, in its development.
6. A GPF member asked about the interaction with the European Financial Reporting Advisory Group (EFRAG) regarding the work plan. Peter Clark clarified that the IASB and EFRAG would continue to co-operate.

Disclosure Framework

7. Alan Teixeira, the IASB's Senior Director of Technical Activities, gave an update on the disclosure framework project. Mr Teixeira explained that the purpose of the project is to develop a disclosure framework that provides users of financial statements with disclosures that are useful without overburdening preparers.
8. Mr Teixeira updated CMAC and GPF members on the discussion on this topic at the June IFRS Advisory Council meeting. He said that in this project there is no expectation to make short-term fixes to the disclosure requirements in individual standards. Rather, the IASB will reinvigorate the conceptual framework project, including two chapters related to disclosure (one about presentation and another about disclosure).
9. Mr Teixeira stated that the IASB intends to create an international forum comprising preparers, auditors, securities regulators and users of financial statements in an effort to cease the current "checklist mentality" relating to disclosures and to get more clarity about what information is important to users of financial

statements. He noted that by doing so, the IASB might become aware of some disclosures that are unhelpful which we can fix in the short term.

10. Nicholas Cappiello, a project manager at the FASB who joined the discussion via phone, stated that the staff of the FASB is nearly finished preparing a discussion paper on disclosures with an invitation to comment. Filippo Poli, a project manager at EFRAG, said that EFRAG was also close to issuing a discussion paper on this topic.
11. A GPF member stated that it would be helpful to discuss the disclosure framework in the context of real life examples with real companies.
12. After the session, GPF and CMAC member discussed in non-public breakout sessions how to improve disclosures in the context of a real life example.

Leases

13. Jessica Lion, IASB staff, gave an update on the June Joint Board meeting regarding boards' tentative decisions for lessee and lessor accounting. Ms Lion asked the GPF and CMAC members about their views in respect of the current proposals, both, conceptually and regarding any practical problems in implementing the current proposals.
14. A GPF member asked about the wording of the current proposals regarding the notion of 'economic life'. GPF members were concerned that when applying the wording whether this notion is interpreted at the total economic life of the underlying asset or the remaining economic life of the underlying asset. They were concerned that if it was interpreted as the remaining economic life, entities would get different accounting depending when in the life of the underlying asset, that entity leased the asset. Some CMAC members said were not concerned about having different profit and loss accounting treatments in the income statement depending on when in the life of the underlying asset the lessee leases the asset, because in their view the different profit and loss accounting treatments represent the different economics or businesses. Other CMAC members stated that the second 'unless' criteria, referring to the present value of the lease payments relative to the fair value of the underlying asset, would lead be likely to lead to a consistent answer in many cases.

15. Jan Engström, IASB member, stated that it was not the intention of the IASB to obtain different accounting treatments in the income statement depending on when during the life of the underlying asset the lessee leases the asset and that the IASB will work on the wording to clarify that.
16. Some GPF and CMAC members were concerned about the complexity that would result from the dual model approach for lessee accounting (eg identifying the nature of an underlying asset). They were concerned about the structuring opportunities a dividing line between different types of leases may create and the decreased comparability of financial statements that may result from such a line. They noted that a dual model would also require more disclosure. CMAC members were less concerned about the front loading effect of the interest and amortisation approach in the income statement as it would not be significant on a portfolio basis.
17. A GPF member asked why the boards decided to use the principle of consumption to distinguish between different types of leases. They expressed favour for using a line similar to the current line in IAS 17 *Leases*, because preparers would be familiar with how to apply such a line. They noted that the current proposals regarding the line would add complexity in respect to how to define the term ‘insignificant’. The boards tentatively decided that a lessee should distinguish between the two different types of leases on the basis of whether the lessee acquires and consumes more than an insignificant portion of the underlying asset over the lease term. In support of simplicity, another GPF member suggested using the single lease expense approach for all types of leases and presenting information about the different economics of different leases in the disclosures.
18. Aida Vatrenejak, IASB staff, responded that the IASB rejected an IAS 17 approach as well as a single lease expense approach for all types of leases, because under both approaches leases that contain a significant financing element would be accounted for with a straight-line expense pattern in the income statement, and in the boards’ view would not reflect the economics of those types of leases (eg a 20 year lease of an airplane).
19. Ms Lion, IASB staff, asked the CMAC and GPF members how cash flows should be presented in the cash flow statement under a single lease expense approach.

CMAC members were divided in their views whether to present cash flows as a single line item or whether to split between financing and operating.

20. Ms Lion, IASB staff, asked the CMAC and GPF members whether, in their view, the IASB should require entities to present interest on the lease liability in the notes for leases applying the single lease expense approach. CMAC members were split in their views on whether the interest charge should be disaggregated from the lease expense. One CMAC member said that presenting the unwinding of the lease liability as an interest expense would be a meaningless number under the single lease expense approach, because the discount rate does not reflect the true economic financing element as for these types of leases all of the lease expense is a financial compensation to the lessor (ie this member would consider the whole lease payment to be an interest expense). Other CMAC members were of the view that interest recognised on the lease liability would be a useful number.

Revenue Recognition

21. Allison McManus, IASB staff member, gave an update on the project. She explained that the comment letter period was now over and the feedback was given to the Board in May which was mostly positive. She noted that redeliberations would begin in July which would include discussing the onerous test. The staff was considering whether or not the onerous test should be in an IFRS on revenue recognition and so one of the aims of the session was to obtain feedback on the onerous test.
22. Ms McManus noted that if the test is not in the revenue standard, the IASB could apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to all contracts with customers, but the answer in US GAAP is not as clear because loss recognition guidance is scattered and is currently industry specific. Prabhakar Kalavacherla, an IASB member, also noted that IFRS users and preparers could use IAS 37 with a few tweaks, but this would not aid convergence.
23. Ms McManus noted that, should the test remain, the staff are considering improvements to the elements of the onerous test including:
- (a) changing the scope of the test to apply to all performance obligations;

- (b) changing the unit of account to the contract level and changing the inflows considered the onerous test to an 'economic benefits' notion (as used in IAS 37 today);or
- (c) changing the outflows considered in the onerous test to limit the costs to those that are incremental to the contract.

24. A GPF member said that it is onerous if there is a requirement to fulfil. In the airline example, the airline has an option to cancel so this doesn't seem onerous at the date the ticket is sold. They like IAS 37 – revenue is the revenue, performance is the requirement. A CMAC member agreed – they weren't convinced by the necessity to introduce an onerous obligation concept into revenue as this isn't seen as a big problem. IAS 37 should be used to capture it when you get there. They said that if they were being political then convergence may not be the best answer, so is it better to go with the better/best answer than convergence?

25. Some GPF members said that they welcomed the move to unit of account being at the contract level, with reasons such as:

- In most cases the company sets the price based on the contract level.
- If the contract is being managed as a whole then it doesn't make sense for this to be separated.
- More holistic alignment of business model with what was reflected.

A GPF member noted there could be problems if the performance obligation that is deemed to be onerous happens later in the overall contract life and they queried what you do in that situation. Allison McManus said unit of account should be at the remaining performance obligations in the contract, so when the remaining performance obligation is onerous, you would be required to recognise an onerous loss.

26. However, a CMAC member said this it should be at the obligation level, as they were concerned about the business model as this changes with management. Management can decide how they argue the business model so they can change the score-keeping. It would be a better answer if done on the pieces of the contract – on the economic themed activity.

Agenda consultation

1. Alan Teixeira, IASB Senior Technical Director, discussed the outcomes of the 2011 agenda consultation and the next steps. He described the standard setting process as having a research programme and a standards programme. The research programme would include the development of discussion papers, which would happen before a project is added to the IASB's work plan. He said that the plan is to operate the research programme in close cooperation with national standard setters. He also explained that the IASB will conduct post-implementation reviews, will work more closely with the Interpretations Committee (as described in the recently revised *Due Process Handbook* that is out for public comment) and will look into areas that need maintenance.
2. Mr Teixeira gave an update on the IASB's decisions in May 2012 about the projects to add to the work plan. Some of those projects, such as the equity method in separate financial statements and IAS 41 *Agriculture* in relation to bearer crops, are expected to result in the publication of Exposure Drafts in the short term because they are either narrow in scope or national standard setters had done a significant amount of work on the topic already. Other topics, such as discount rates and the equity method of accounting, are candidates for the research programme and are likely to lead to discussion papers first.
3. He described the recent review of the Interpretations Committee and the decisions on changing the way it operates so that it can be more responsive. Mr Teixeira explained that in the future, there would be more interpretations and more focus and sharpness around the rejections, as well as fewer rejections because the IASB would be considering the issues on its active agenda.

Process for soliciting input for making narrow scope amendments

27. Hilary Eastman, IASB staff member, stated that through the IASB's outreach on the agenda consultation and other means, investors and others have suggested areas in which they think financial reporting could be improved. Consequently, the IASB is giving thought to how best to develop a means for stakeholders to provide such suggestions. In particular, she explained that they were trying to look at a more systematic way of getting input without the need for investors and

others to write formal letters, and gave some examples of some ways they were thinking of doing this, including putting a form on the IFRS website. Ms Eastman asked for feedback on the ideas any other ideas for ways to get input.

28. A GPF member suggested consulting with the ‘Big 4’ IFRS desks; however, Ms Eastman said that the IASB receives input from those organisations and there is a process in place for them to provide input. Alan Teixeira, IASB staff member, noted that the IFRS desks tend to say when they’re struggling with the words and Ms Eastman noted that such suggestions feed into the annual improvements process. She also noted that the potential for making narrow scope amendments identified in the agenda consultation technically would not meet the annual amendments or Interpretations Committee criteria. Furthermore, the IASB is looking at how to obtain the information that has not been communicated.
29. A CMAC member suggested that financial statement users could be given the opportunity to send examples of financial statements that they do not have enough information about. The CMAC member said that the industry should get into the culture of putting aside the examples that are bothering them and let the standard setter know about them. Ms Eastman said that this would help the IASB to know what the problem is from a financial statement analysis perspective.
30. Another CMAC member said that there should be a structured approach to the problem. In other words, the IASB needs to identify its “customers”, and then reach out to those customers. The CMAC member said that the IASB needs to think about who are the most likely users of an item in the financial statements or note disclosures and then reach out to five or ten of them, selecting a different set of investors and analysts from time to time. The CMAC member was concerned that the approach for getting input should not be too open-ended (eg asking users of financial statements for their views on what needs to be fixed in financial reporting) because, if it is, the IASB will not necessarily get representative examples of what the issues are.
31. A CMAC member said that regardless of the outreach activity, the IASB should make it a point respond to the people that give feedback and let them know what has been done with their suggestions. That CMAC member thinks being responsive in that way might encourage investors and others to provide more input in the future.

Financial Instruments: Impairment

32. Sara Glen, IASB staff member, discussed the proposed expected loss impairment model and said that she would like to focus the session on the disclosures. She reminded the group that management would be required to use judgment when moving through the buckets and estimating expected credit losses, and the disclosures to be discussed were developed to help users of financial statements understand those estimates.
33. Ms Glen noted that the proposed model would apply to everything at amortised cost or fair value through other comprehensive income. Manuel Kapsis, IASB staff, said that entities would need to take into account market information about expected credit losses, and said that the objective of the impairment model is to capture the deterioration and improvement in credit quality.
34. Ms Glen then asked CMAC and GPF members what information provided today is useful in understanding the credit quality of an entity.
35. A CMAC member said that they would need to see the originations in Bucket 1 and the transfers between buckets, as well as what relates to the current year that stays in Bucket 1. Patrick Finnegan, an IASB member, said that he agreed that such information should be disclosed. However, he has heard from the banking industry that presenting this type of information (ie 'flow' information) is operationally difficult for the banking industry.
36. A CMAC member said that they believe speaking about three different buckets gives the sense that there are three different measurement methods when there are only two (12 months and lifetime).
37. Another CMAC member said that Bucket 2 and Bucket 3 are determined by the systems an entity uses – some may put it in Bucket 2 and some may put it in Bucket 3. They said that some possible disclosures are:
 - More information about the collateralised nature of the loan
 - How much is guaranteed
 - How much is property backed versus relying on cash flows
 - Floating charge over inventory/debtor balance
 - Life of the sovereign debt

38. A GPF member said that they hope the IASB develop some simplified disclosures for non-financial companies, such as manufacturing companies, similar to existing accounting standards.

Financial Instruments: Classification and Measurement

39. Yulia Feygina, IASB staff member, explained that the key objectives in replacing IAS 39 *Financial Instruments: Recognition and Measurement* were to reduce complexity and to move to a principles-based versus a rules-based approach. She noted that last year the IASB decided to consider limited modifications to IFRS 9 *Financial Instruments* with three objectives:

- (a) To address the interaction with the insurance project.
- (b) To consider areas of convergence with the FASB.
- (c) To address application feedback on IFRS 9.

She introduced the discussion on the modified business model assessment regarding debt investments at FVOCI.

40. A CMAC member queried why a third measurement category was being re-introduced for debt instruments. Ms Feygina noted the interaction with the insurance project and also mentioned that the limited outreach with the banking industry indicated that a FVOCI category could provide useful information for some portfolios, eg those managed to maximise yield. Ms Feygina also noted that she thought one of the concerns behind the question was whether complexity would be reduced if there were a third measurement category for debt instruments, and in response she noted that the same impairment model would apply to debt instruments measured at FVOCI as would apply to assets measured at amortised cost (unlike the current requirements in IAS 39).
41. A CMAC member asked whether assets could be measured at amortised cost if they are managed to maximise yield. Ms Feygina responded that if sales are more than infrequent, such assets would not qualify for amortised cost. The CMAC member commented that maybe amortised cost and FVPL would be sufficient for portfolios managed to maximise yield.

42. A CMAC member suggested that maybe the FVOCI category for debt instruments should only be used if there is a matching liability. They wouldn't favour the introduction of a FVOCI category solely for the purpose of reducing P&L volatility and confirmed that his preference would be to only accommodate those with an accounting mismatch because of their liabilities.
43. A GPF member noted that without the introduction of a FVOCI category for eligible debt instruments, investments that are required by regulation to be set aside to cover an asset retirement obligation would be measured at FVPL because the investment manager manages them to maximise yield. They did not think that recognising fair value changes in P&L for these instruments would provide useful information.
44. A CMAC member stated a view that if an instrument is not senior debt (ie in securitisation) then it has the same risk profile as equity, should not be considered 'simple' and should not be eligible for FVOCI. If a FVOCI category were added to IFRS 9, the timing of gain or loss recognition in P&L could be chosen for such a portfolio. That CMAC member continued by stating the view that adding another category is confusing and blurs the distinctions between them, and that this sounds like special accounting for the insurance companies. Another CMAC member asked if this could go in the insurance standard.
45. Yulia Feygina then discussed the proposed modifications to the contractual cash flow characteristics assessment. She said that if the contractual cash flows only have components that are principal, time value of money and credit risk (of the issuer), but the relationship between the components is not perfect, then an entity would need to assess the degree of modification in the relationship. The actual instrument would be compared to the 'perfect' instrument, and if the effect of the modification is more than significant, the instrument would not be eligible for a measurement category other than at fair value through profit or loss.
46. A CMAC member questioned whether it was possible to be certain that any financial assets components are limited to those noted by Ms Feygina, eg a liquidity component. However, Ms Feygina responded that you would definitely know if there's an ineligible component. She noted that the Basis for Conclusions for IFRS 9 does talk about liquidity risk which is an allowed component within the interest rate. A GPF member noted that the time value of money is the risk-

free rate and that normally interest rates reflect more premiums than just the credit risk of the borrower – for example, a retail customer would be charged more than a corporate because there is an increased cost to serve that customer. Mr Kalavacherla, IASB Board member, said that if those factors are related to the borrower he would not think that this would preclude amortised cost classification.