

STAFF PAPER

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REG IASB Meeting

Project	Financial Instruments: Classification and Measurement		
Paper topic	Due process considerations for proposing limited amendments to IFRS 9		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Purpose

1. This paper considers whether the IASB has complied with its due process requirements and should proceed to publish an Exposure Draft proposing limited amendments to IFRS 9 *Financial Instruments*.
2. The IASB's Due Process requirements set out the mandatory and optional steps that need to be undertaken or considered before the publication of an Exposure Draft. The IASB is required to explain why it has determined that it was not necessary to undertake any of the optional steps (i.e. the 'comply or explain' approach). As a general rule, because constituents will have the opportunity to comment on the proposals before they are redeliberated and finalised, and because additional work will be undertaken during redeliberations, the due process steps that are needed in order to publish an Exposure Draft are less comprehensive than those for issuing final requirements.

Background

3. When IFRS 9 was deliberated and issued, the IASB acknowledged the difficulties that might be created by differences in timing between the project to replace IAS 39 and other projects, in particular the insurance contracts project. Since the publication of IFRS 9, the IASB has

consistently stated that the interaction between IFRS 9 and the insurance contracts project will be considered once the insurance contracts model has been developed sufficiently¹.

4. The project to revise the accounting for financial instruments started as a joint project between the IASB and the US Financial Accounting Standards Board (FASB). The convergence efforts with the FASB were also complicated by the different project timetables established to respond to the boards' respective stakeholder groups. The IASB therefore issued IFRS 9 while the FASB was still redeliberating the proposals in its May 2010 proposed Accounting Standards Update (ASU) *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*. However, the boards remained committed to achieving increased comparability internationally in the accounting for financial instruments. The IASB has committed to seek feedback from its constituents on the FASB's classification and measurement model and to consider whether and what should be done to reconcile any differences.
5. Since the publication of IFRS 9, the IASB has received feedback from constituents from various jurisdictions that have chosen to early adopt IFRS 9 or have started preparation for the adoption of IFRS 9. Generally the feedback has been positive and IFRS 9 has been found to be conceptually sound and operational. However, some constituents have raised application questions related to the classification of specific instruments.
6. In November 2011, the IASB concluded that the insurance contracts project and the FASB's tentative classification and measurement model have been sufficiently developed to consider the interaction between accounting for financial assets and insurance contract liabilities and potential ways to increase comparability with the FASB's tentative classification and measurement model. In addition, the IASB concluded that it was appropriate to consider the feedback from the entities that early applied IFRS 9 and those who have started the preparation for application to refine and improve IFRS 9 before it became mandatorily applicable. Accordingly, the IASB decided to consider making limited improvements to IFRS 9 in order to:

¹ See the Basis for Conclusions to IFRS 9, paragraph BCIN.2

- (a) address specific application issues raised by those who have early adopted IFRS 9 or who have reviewed IFRS 9 in detail in preparation for application;
- (b) consider the interaction between the accounting for insurance contract liabilities and the accounting for financial assets; and
- (c) consider reducing differences with the FASB's classification and measurement model for financial instruments.

In January 2012, the IASB and the FASB decided to jointly redeliberate selected aspects of their classification and measurement models to seek to reduce key differences.

7. In making this decision, the IASB noted that IFRS 9 has been found fundamentally sound and operational. In addition, the IASB noted that some constituents have already applied IFRS 9 and others have devoted significant resources to preparing for transition and committed to seek to minimise the cost and disruption to those constituents where possible. The IASB also acknowledged the need to complete the project expeditiously to enable IFRS 9 as a whole to be completed and for it to be available for application in its entirety. Accordingly, the IASB decided to limit the scope of the project to addressing the areas outlined in paragraph 6.

Main changes proposed to IFRS 9

8. The following paragraphs outline the key changes proposed to IFRS 9 as a result of this project.
9. **Contractual cash flow characteristics of financial assets** - IFRS 9 requires that, subject to the business model assessment, a financial asset is eligible for a measurement category *other than* at fair value through profit or loss (FVPL) if its contractual cash flows solely represent payments of principal and interest (P&I)². IFRS 9 contains application guidance, including illustrative examples, that explain how the principle should be applied.
10. Since the publication of IFRS 9, the IASB has received questions about application of the principle to particular instruments. Constituents have expressed concerns that the application

² Interest is consideration for the time value of money and the credit risk associated with the principal amount outstanding during a particular period of time.

guidance in IFRS 9 could be interpreted in a way that would result in some financial assets that contain contractual cash flows that *economically* represent solely payments of P&I being classified at FVPL. The IASB has considered the feedback received from constituents and tentatively decided to propose a minor amendment to IFRS 9 to clarify how the principle should be applied. The staff have received preliminary feedback that this tentative decision in many, although not in all, cases addresses the relevant concern raised by constituents.

11. The addition of the fair value through other comprehensive income (FVOCI)

measurement category for financial assets – IFRS 9 currently requires that all financial assets are classified at amortised cost or FVPL on the basis of the business model within which they are held and their contractual cash flow characteristics.

12. Many constituents supported, and continue to support, the current approach in IFRS 9 of having only two categories³. However, some constituents expressed a view that the classification model in IFRS 9 would not allow them to properly reflect their business models for groups of assets which they hold to both collect contractual cash flows or to sell. In addition, insurers have raised concerns about the potential accounting mismatch that may arise due to the interaction between accounting for financial assets under IFRS 9 and accounting for insurance liabilities under the insurance contracts project. Some respondents to the *Insurance Contracts* ED advocated a FVOCI classification category for particular financial assets, while also reporting the effect of changes in the interest rate associated with the insurance contract liability in other comprehensive income (OCI). Finally, the FASB's tentative model contained a FVOCI category for financial assets.

13. The IASB has acknowledged the considerations discussed in paragraph 12 and has tentatively decided to propose the addition of the FVOCI measurement category for debt instruments that:

³ IFRS 9 permits an entity to make an irrevocable election at initial recognition to present fair value gains and losses on an investment in an equity instrument in other comprehensive income (OCI). No changes are being proposed to this option.

- (a) are managed within a business model whose objective is both to hold the financial assets to collect contractual cash flows and to sell the financial assets; and
- (b) Contain cash flows that are solely P&I.

This is the most significant of the changes proposed to IFRS 9.

14. Some constituents may question the need for the FVOCI category and/or the articulation of the respective business model. They may also question the overall benefit of the resulting classification model in IFRS 9 compared to IAS 39 that requires financial assets classified as available-for-sale to be measured at FVOCI. The IASB has considered these potential concerns in deliberating and concluded that:

- (a) The introduction of the FVOCI category is consistent with the objectives of the project, i.e. to reduce key differences with the FASB's model and to address the interaction with the insurance contracts project;
- (b) The articulation of the business model that qualifies for FVOCI classification (subject to the contractual cash flow characteristics assessment) could be supported by application guidance;
- (c) The eligibility for and the mechanics of the proposed FVOCI category in IFRS 9 are principle-based and sufficiently different compared to those prescribed by IAS 39.

Due process

Required steps

Board meetings held in public, with papers available for observers. All decisions are made in public session.

15. The IASB has held public meetings on this project between November 2011 and this meeting. Before the meetings, the staff papers have been posted on the website for observers. All of the tentative decisions have been made in those public meetings, and summaries of the tentative decisions reached were posted on the website after each meeting.

Formal consultation with the Trustees and the Advisory Council

16. At the February 2012 Advisory Council meeting, this project was discussed in the session on the financial instruments projects.

Publication of effect analysis

17. The staff have analysed the likely effects of the proposals, which will be published and provided to the Due Process Oversight Committee.

Translations and XBRL teams included in review process

18. The translations and XBRL teams will be included in the review process before the publication of an Exposure Draft.

Exposure Draft published with an appropriate comment period

19. In Agenda Paper 6E from this meeting, the staff will ask the IASB for permission to draft an Exposure Draft proposing limited amendments to IFRS 9, and provide an analysis of the appropriate comment period for these proposals.

Optional steps

Webcasts and podcasts to provide interested parties with high level updates or other useful information about specific projects

20. The staff have held webcasts to update constituents on the proposals on 30 and 31 July 2012. The webcasts and the slides are available on the IASB website for playback and download.

Public discussions with representative groups

21. This project was discussed with the Capital Markets Advisory Committee and the Global Preparers' Forum. The agenda papers discussed at the meeting and an audio recording of the session are available on the IASB website for download and playback.

External reviewers used to review drafts and comments collected and considered by the IASB

22. External reviewers will review the Exposure Draft during its development. Comments will be provided to the IASB and considered in drafting the Exposure Draft.

Review draft made available to members of IFASS and comments collected and considered by the IASB

23. The staff will make a draft of the Exposure Draft available to members of the International Forum of Accounting Standard Setters (IFASS) during its development. Comments will be provided to the IASB and considered in drafting the Exposure Draft.

Press release and snapshot

24. To make constituents aware of the opportunity to provide feedback on the proposals, a press release will be issued to announce the publication of the Exposure Draft. In addition, the staff will publish a ‘snapshot’ of the Exposure Draft, which will help constituents to understand the basic concepts in the proposals.

Additional consultative steps during redeliberations on the Exposure Draft

25. Constituent views have been considered during the development of these proposals and do not negate the IASB’s reasons for making its proposals. Some constituents might agree with, and others might disagree with, aspects of the proposals—for example, the scope of this project, the proposed amendments to IFRS 9, and what amendments have **not** been proposed (for example, not proposing that bifurcation of financial assets be reintroduced). Constituents will have the opportunity to comment on the Exposure Draft and their views will be further considered during the comment period and during the redeliberations on the Exposure Draft.

26. In addition to considering the comments received, the IASB will perform more extensive outreach to consider the views of various constituent groups and jurisdictions.

27. As the IASB gathers more information, it will be able to consider what other consultative steps should be performed before finalising limited amendments to IFRS 9.

Summary

28. In the staff's view, the IASB has complied with all the required steps in the Due Process Handbook and has performed sufficient optional due process steps in developing the proposed limited amendments to IFRS 9 to be able to proceed to an exposure draft. In paper 6E we ask for permission to begin the balloting process for the exposure draft.

Appendix A: Required and optional due process steps for developing and publishing of an exposure draft for an IFRS

Step	Required/Optional	Metrics or evidence	Protocol for and evidence provided to DPOC	Action
Board meetings held in public, with papers available for observers. All decisions are made in public session	Required	Meetings held to discuss topic Project website contains a full description with up-to-date information on the project Meeting papers posted in a timely fashion	Members of the IASB discuss with DPOC progress on major projects, in relation to the due process being conducted DPOC reviews comments from interested parties on IASB due process as appropriate	The Board meetings leading to the issue of this exposure draft were held in public between November 2011 and July 2012. All decisions were made during those sessions. The meeting papers were posted in a timely fashion. The website contained relevant historical information and up-to-date summaries of the decisions reached at the meetings.
Formal consultation with the Trustees and the Advisory Council	Required	Discussions with the Advisory Council on topic	DPOC meets with the Advisory Council to understand perspectives of stakeholders on due process of IASB Advisory Council chair invited to Trustees' meetings and meetings of DPOC	At the February 2012 Advisory Council meeting, this project was discussed in the session on the financial instruments projects.
Analysis of likely effects of the forthcoming IFRS or major amendment, for example, costs or ongoing associated costs	Required	Publication of effect analysis	IASB reviews with DPOC results of effect analysis and how it has considered such findings in proposed IFRS IASB provides a copy of the effect analysis to the DPOC at the point of standard's publication	The staff has analysed the likely effects of the proposed amendments and will provide a copy of this analysis to the DPOC when the exposure draft is published.
Consultative groups utilised, if formed	Optional	Number of consultative group meetings, and evidence of substantive involvement in issues Consultative group review of draft exposure draft	DPOC receives report of consultative group activity from IASB	The use of a consultative group was not considered necessary in developing these proposals. The proposed amendments respond to practice issues that the IASB has become aware of as a result of its outreach activities. The Board is proposing limited amendments to an existing IFRS, and constituents will have an opportunity to comment on these proposals.

Step	Required/ Optional	Metrics or evidence	Protocol for and evidence provided to DPOC	Action
Fieldwork undertaken in analysing proposals	Optional	IASB describes approach taken on fieldwork IASB explains why it does not believe fieldwork is warranted, if that is the preferred path Number of field tests	If fieldwork is deemed by the IASB as not required, DPOC to review and discuss the explanation with IASB DPOC receives a report on fieldwork activities and how findings have been taken into consideration by IASB	The Board did not consider it necessary for separate fieldwork to be performed on the proposed amendments. The Board is proposing limited amendments to an existing IFRS, and constituents will have an opportunity to comment on these proposals.
Outreach meetings with a broad range of stakeholders, with special effort for investors	Optional	Number of meetings held and venues documented Evidence of specific targeted efforts for investors	DPOC receives a report on outreach activities and reviews, with the IASB, the outreach plan for the ED and its approach to the optional steps to ensure extensive outreach and public consultation	The Board conducted focused outreach to gather information needed to develop the proposed amendments. The Board will undertake more extensive outreach during the comment period and redeliberations on the exposure draft to consider the views of various constituent groups and jurisdictions.
Webcasts and podcasts to provide interested parties with high level updates or other useful information about specific projects	Optional	Number of and participation in webcasts	DPOC receives a report on outreach activities	The staff presented webcasts of these proposed amendments on 30 and 31 July. These webcasts and the slides are available for playback/download on the website.
Public discussions with representative groups	Optional	Number of discussions held	DPOC receives a report on outreach activities	This project was discussed with the Capital Markets Advisory Committee and the Global Preparers' Forum. The agenda papers discussed at the meeting and an audio recording of the session are available on the IASB website for download and playback.
Online survey to generate evidence in support of or against a particular approach	Optional	Number and results of surveys	DPOC receives a report on outreach activities	An online survey was not considered necessary in order to develop these proposals.

Step	Required/ Optional	Metrics or evidence	Protocol for and evidence provided to DPOC	Action
IASB hosts regional discussion forums, where possible, with national standard-setters	Optional	Schedule of meetings held in these forums	DPOC receives a report on outreach activities	Regional discussion forums were not considered necessary in order to develop these proposals.
Round-table meetings between external participants and members of the IASB	Optional	Number of meetings held	DPOC receives a report on outreach activities	Round-table meetings were not considered necessary in order to develop these proposals.
Drafting quality assurance steps are adequate	Required	Translations team included in review process	DPOC receives summary report on due process steps followed before an exposure draft is issued	The translations team reviewed drafts of these proposals before they were published.
Drafting quality assurance steps are adequate	Required	XBRL team included in review process	DPOC receives summary report on due process steps followed before an exposure draft is issued	The XBRL team reviewed drafts of these proposals before they were published.
Drafting quality assurance steps are adequate	Optional	External reviewers used to review drafts and comments collected and considered by the IASB	DPOC receives summary report on due process steps followed before an exposure draft is issued, including the extent to which external reviewers have been used in the drafting process	Drafts of the proposed amendments were sent to external reviewers. Their comments were collected and considered in the drafting process.
Drafting quality assurance steps are adequate	Optional	Review draft made available to members of IFASS and comments collected and considered by the IASB	DPOC receives summary report on due process steps followed before an exposure draft is issued	Drafts of the proposed amendments will be sent to members of IFASS. Their comments will be collected and considered in the drafting process.
Drafting quality assurance steps are adequate	Optional	Review draft posted on project website	DPOC receives summary report on due process steps followed before an exposure draft is issued	A review draft of these proposals was not considered necessary. The Board is proposing limited amendments to an existing IFRS and constituents will have the opportunity to comment on the proposals when they are published.
Due process steps reviewed by IASB	Required	Summary of all due process steps discussed by the Board before an IFRS is issued	DPOC receives summary report on due process steps followed before an exposure draft is issued	This paper provides an analysis for a Board discussion on the due process steps undertaken in this project.

Step	Required/ Optional	Metrics or evidence	Protocol for and evidence provided to DPOC	Action
Exposure draft has appropriate comment period	Required	IASB sets comment period for response Any period outside the normal comment period requires explanation from IASB to DPOC, and subsequent approval	DPOC receives notice of any change in comment period length and approval if required	In Agenda Paper 6E from this meeting, the staff recommend a standard comment period of 120 days.
Press release to announce publication of exposure draft	Optional	Press release published Media coverage	DPOC informed of the release of the exposure draft	A press release will be issued when these proposals are published.
Snapshot document to explain the rationale and basic concepts included in the exposure draft	Optional	Snapshot posted on IFRS Foundation website	DPOC receives a report on outreach activities Snapshot sent to DPOC members	A snapshot will be issued when these proposals are published.
Exposure draft published	Required	Exposure draft posted on IFRS Foundation website	DPOC informed of the release of the exposure draft	The exposure draft will be posted on the website.