AGENDA PAPER

IFRS Foundation Trustees' meeting

Sydney	April 2014	**Agenda Paper**	**2**

Memorandum

To: IFRS Foundation Trustees

From: Hans Hoogervorst

Date: 27 March 2014

Re: Report of the IASB Chairman

Introduction

1. I am pleased to provide a report on developments since our joint meeting with the Monitoring Board in January 2014.

Work plan

2. In the last quarter we have focused on the finalisation of the impairment and classification and measurement chapters of IFRS 9 *Financial Instruments*. These represent the final elements of the IASB's response to the global financial crisis. We are now in the completion phase of the project and we expect to issue the revised Standard this summer.

3. We will also shortly publish a Discussion Paper on addressing the accounting for macro hedging and will also soon issue our new, fully-converged Revenue Recognition Standard.

4. As we close the accounting chapter on the financial crisis we are also working intensively on our final round of redeliberations on two further major projects: Leases and Insurance Contracts. We expect to complete our deliberations of the feedback on these two project this year and issuing the Standards in 2015.

5. The comment period for the Discussion Paper on the Conceptual Framework closed on 14 January 2014 and has elicited numerous high quality and thoughtful responses. In March 2014 we discussed a summary of the comment letters received and we will commence redeliberations of the proposals in the Discussion Paper shortly. I am sure the IASB will have some interesting discussions as we develop the Exposure Draft.

6. Our research agenda is really starting to take shape, featuring a number of important projects that have the potential to deliver substantial improvements to the quality of financial reporting.

7. Finally, we are making rapid progress with our Disclosure Initiative. Around this time last year, we held a forum to encourage the various participants in the financial reporting supply chain to discuss what can be done, collectively and individually, to improve the quality and usefulness of financial disclosures. Building on these discussions, in June last year I set out a 10-point plan to encourage material, meaningful improvements in this area and we are making good progress in the implementation of this plan.

Engagement strategy

8. As part of our strategy to develop a single set of high quality, understandable, enforceable and globally accepted International Financial Reporting Standards it is important that we have an effective engagement strategy with all stakeholders of the financial reporting community. We have devoted additional resources at the end of 2013 and the first quarter of this year to reviewing our engagement strategy with investors and improving our discussions on feedback received from these stakeholders. For example, as discussed at the Due Process Oversight Committee meetings in January[1] and this month (see Agenda Paper 3F) the staff will summarise investor feedback received and post these summaries to our website. When the IASB makes significant project decisions, the staff will also follow up with the investors that have provided feedback on their projects. This will help investors to better understand how their views have been considered, in turn increasing the transparency of our process as well as improving relationships with investor stakeholders.

9. The Accounting Standards Advisory Forum (ASAF) enables us to communicate effectively with national standard-setters, while ensuring that we receive a broad range of national and regional advice on major technical issues. In March 2014 we had a very positive meeting with the ASAF on a broad range of key issues.

[1] See http://www.ifrs.org/Meetings/MeetingDocs/Trustees/2014/January/AP3F%20Outreach%20and%20Correspondence.pdf

Use of IFRS globally

10. As I reported to you in January we have made an important step in assessing our progress towards the goal of globally accepted accounting standards, by developing profiles about the use of IFRSs in individual jurisdiction profiles[2]. In this quarter we have updated seven of our existing profiles, including Japan where 34 companies have either started to use IFRS or have publicly announced their intention to do so. The revised profile also explains that in October 2013, to encourage further application of IFRS in Japan, the Japan Financial Services Agency broadened its criteria for use of IFRS. As a result, the number of companies eligible to apply IFRS was increased from 621 to 4,061, covering virtually all listed companies and those planning to list.

Consistency in the application of IFRS globally

11. We have also continued to take steps to ensure IFRSs are applied and enforced on a globally consistent basis. Earlier in March, the IFRS Foundation and the International Valuation Standards Council (IVSC) announced a joint statement of protocols for co-operation on International Financial Reporting Standards and International Valuation Standards (IVS).

12. Both the IVSC and the IFRS Foundation have a shared interest in the consistent measurement of fair value for financial reporting. Some Standards issued by the IASB use fair value as a measurement basis. The IASB has also published IFRS 13 *Fair Value Measurement*, which sets out the principles for measuring fair value when it is required to be used in our Standards. The IVSC has standards and guidance on fair value and other valuation measurement, and facilitates collaboration and co-operation among its member organisations to help ensure consistent application.

13. The aim of the agreement is to ensure that both organisations are able to co-operate effectively in this important area with each organisation continuing to assume sole responsibility for its own Standards.

14. As noted previously our goal of consistent application is supported by the Education Initiative, which makes available high quality, understandable, and up-to-date material about IFRS. A more detailed update on the Education Initiative will be discussed in Agenda Paper 5B.

Effect analysis

15. The Effects Analysis Consultative Group was formed in response to the Trustees'

[2] As at the date of writing we have completed 129 jurisdiction profiles.

strategic plan. The group had face-to-face meetings in May, July and November 2013 and met by conference call in November 2013.

16. Dr Alan Teixeira has been drafting the report. The first draft was viewed by the DPOC in October 2013, and a summary of the main conclusions was considered by the IFRS Advisory Council (IFRS AC) at the same time. The feedback from the DPOC and the IFRS AC was conveyed to the Effects Analysis Consultative Group and this feedback has been reflected in the second draft of the report, which members and observers of the Consultative Group are now considering. This second draft was also distributed to the DPOC for consideration at this meeting.

17. The plan is to finalise the report in the second quarter of 2014. I think this is an important step for the IASB, because it sets out how we will undertake and report on an assessment of the likely effects of changes to financial reporting that the IASB is proposing.

Technical Agenda

18. In the first quarter we have issued our interim standard, IFRS 14 *Rate-regulated Activities.* IFRS 15 *Revenue from Contracts with Customers* is in the final stages of completion and we expect to issue the Standard in April 2014. We have also published:
    - Request for Information: Post-implementation Review: *IFRS 3 Business Combinations*;
    - The 2013 *IFRS Taxonomy*; and
    - Exposure Draft: Disclosure Initiative *Proposed amendments to IAS 1.*

Revenue Recognition

19. As noted above we will issue our new Revenue Recognition Standard, IFRS 15 *Revenue from Contracts with Customers*, shortly. As discussed previously, because of the importance of revenue and the broad scope of the new Standard, the IASB and the FASB intend to establish a limited-life transition resource group to support preparers in the transition to the new Standard. Importantly, it is not proposed that the group should provide authoritative guidance.

Financial Instruments

IFRS 9—Classification and Measurement (limited amendments)

20. As noted above, in this quarter we have focused on the finalisation of these amendments to the classification and measurement requirements for financial instruments that are already contained in IFRS 9 *Financial Instruments*, and have now completed all planned technical discussions.

21. The main changes to IFRS 9 are to clarify the notion of principal and interest, to introduce a 'fair value through OCI' category for simple debt investments, and to clarify the concept of 'holding to collect' contractual cash flows.

22. We published an Exposure Draft proposing these amendments in November 2012. The FASB issued its own ED on the classification and measurement of financial instruments in February 2013. While those EDs reflect joint decisions made by the boards, because of the different stage of development of our projects (the IASB is revising IFRS 9 whereas the FASB is proposing completely new guidance), the documents were not identical.

23. The FASB has decided to proceed in this project by making limited amendments to its current standards; as a consequence we will not issue converged standards.

Impairment

24. In this quarter we have also completed our planned technical discussion on our proposed impairment model for IFRS 9.

25. In March 2013 the IASB published an ED *Financial Instruments: Expected Credit Losses.* The proposals in that document were based on the model that the IASB had been developing jointly with the FASB. The proposals would result in expected credit losses always being recognised (from when a financial instrument is first purchased or originated) with full lifetime expected credit losses being recognised when a financial instrument suffers a significant deterioration in credit quality.

26. Overall, the feedback received by the IASB was supportive. In particular, there was support for a model that measures expected credit losses differently on the basis of a significant increase in credit risk. The operationality of the proposals was also confirmed. Some did, however, raise concerns about the timeliness of identification of significant increases in credit risk, so the IASB has considered ways to make the model more responsive to changes in credit risk.

27. As previously noted we have been unable to reach a converged impairment model

with the FASB. The FASB decided in December 2013 to finalise their impairment model (the Current Expected Credit Loss model, or 'CECL model'). Under the CECL model, expected credit losses are always recognised at what is described as 'lifetime expected credit losses'. The CECL model makes no distinction between financial instruments that have experienced a significant increase in credit risk since initial recognition and those that have not, which is a key element of the IASB's tentative model. The IASB's model measures expected credit losses at an amount equal to 12-month expected credit losses for financial instruments for which credit risk has not increased significantly.

28. In February 2014 the IASB discussed the mandatory effective date for the revised IFRS 9 (which will incorporate both the classification and measurement amendments, and the new impairment model) and decided the Standard would be effective for annual periods beginning on or after 1 January 2018. We expect the revised Standard to be issued in the second quarter of this year.

Accounting for Dynamic Risk Management: A Portfolio Revaluation Approach to Macro Hedging

29. All planned discussions on the model for accounting for macro hedging, prior to publication of the Discussion Paper, have been completed and we expect publication in early April 2014.

Insurance Contracts

30. The objective of this project is to eliminate inconsistencies and weaknesses in existing practice by replacing IFRS 4 *Insurance Contracts* and to provide a single principle-based Standard to account for all insurance contracts.

31. As explained in previous meetings, the IASB published its revised Exposure Draft at the end of June 2013. Because of the importance of completing this project, and in view of the extensive debate the IASB has undertaken over the years, the Exposure Draft sought feedback on five key matters on which there have been significant changes to the proposals in the 2010 Exposure Draft. The IASB hoped that targeting its revised Exposure Draft in this way will avoid further undue delay in finalising a much-needed Standard for insurance contracts accounting.

32. The comment period for the Exposure Draft ended on 25 October 2013. The feedback suggests broad support for the proposal; however, there are also significant areas of disagreement and concerns about excessive complexity.

33. The IASB, at its meeting in March 2014, made tentative decisions on two of the five

items that were targeted in the 2013 ED as they relate to non-participating contracts—namely, unlocking the contractual service margin and recognising the effects of changes in the discount rate in other comprehensive income. The direction that the IASB took was largely consistent with the feedback that it had heard on the 2013 ED. The IASB plans to review these decisions in the light of future decisions for participating contracts if necessary.

Leases

34. The objective of the Leases project is to improve the quality and comparability of financial reporting by providing greater transparency about an entity's leverage, the assets it uses in its operations and the risks to which it is exposed from entering into lease transactions.

35. This is a joint project with the FASB. In May 2013, the boards published a joint and revised Exposure Draft on leases, which was open for comment until 13 September 2013.

36. Extensive outreach activities were undertaken during the comment period, focusing in particular on obtaining feedback from users of the financial statements and on understanding the drivers of costs for preparers. The boards started to redeliberate the lessee model, the lessor model and possible scope simplifications in January 2014, with the aim of reaching decisions on those central topics in March 2014.

37. In preparation for the March 2014 meeting the IASB, at its January 2014 meeting, discussed possible alternative solutions to address the matters raised in the comment letters. The IASB also sought advice on the strategy for the project from the Advisory Council at its meeting in February 2014 and advice on the possible alternative solutions was also sought from the ASAF at its meeting in March 2014. We also sought advice on specific aspects from the Capital Markets Advisory Committee and the Global Preparers Forum.

38. At our joint meeting with the FASB in Norwalk in March 2014 we reached tentative decisions on both the lessee and lessor models and on scope simplifications for 'small-ticket' leases:

- Both boards decided to require lessees to recognise assets and liabilities for all leases (other than short-term leases and, for the IASB, leases of small assets such as laptops and office furniture).
- The IASB decided upon a single lessee model, for the recognition and presentation of lease expense, whereby a lessee would recognise interest on

lease liabilities separately from amortisation of lease assets.

- The FASB decided upon a dual lessee model for the recognition and presentation of lease expense, that would retain the existing distinction between operating and finance leases. This would, in essence, result in no change to the lessee's income statement compared with the income statement outcomes under existing requirements.
- Both boards decided to retain existing lessor accounting. Because existing IFRS lessor accounting is slightly different from existing US GAAP lessor accounting, the boards reached slightly different conclusions, which are not expected to result in any significant differences in practice.
- The boards reached converged decisions on the lease term and short-term leases.

39. The boards agreed the project will continue on a joint basis with the aim of reaching converged solutions wherever possible.

Rate-regulated Activities

40. Because we have now published our interim Standard (IFRS 14 *Regulatory Deferral Accounts*) we are now focusing on our research project. In the short term our objective of this research project is to develop a Discussion Paper to consider whether rate regulation gives rise to assets or liabilities in addition to those already recognised in accordance with IFRS for non-rate-regulated activities. A Request for Information *Rate Regulation* was published in March 2013 to gather more information about the common features of rate regulation.

41. We are reviewing the common features of rate regulation that are considered as being most important for distinguishing the rights and obligations created by some types of rate regulation from the rights and obligations applicable to non-rate-regulated entities, and to identify those that have the biggest impact on the amount, timing and certainty of cash flows and the stability of 'regulated' earnings. This analysis has been developed to help identify which feature(s), if any, create special economic conditions for which a specific accounting model might need to be developed. The Discussion Paper will be based on these distinguishing features and will outline a number of potential approaches to developing an accounting model.

The Conceptual Framework

42. As previously reported we are revising our Conceptual Framework following feedback from the 2011 Agenda Consultation. The Conceptual Framework sets out the concepts that underlie the preparation and presentation of financial statements. It is not a Standard or Interpretation and does not override any specific Standard or Interpretation. However, it identifies principles for the IASB to use when it develops and revises its Standards.

43. The Discussion Paper (DP), published in July 2013, was the first step towards issuing the revised Conceptual Framework. The comment period for the DP ended on 14 January 2014. During the comment period, outreach has been conducted to obtain feedback on the issues included in the DP. The IASB also consulted its advisory groups during the comment period—the Advisory Council, the ASAF (which acts as the project team's working group), the Capital Markets Advisory Committee, and the Global Preparers Forum. The feedback from these groups gave support for continuing the project.

44. At the March 2014 IASB meeting, the staff presented a paper that analysed the comment letters received on the DP.

45. Our original intention was not to fundamentally reconsider the chapters of the Conceptual Framework that were published in 2010. However, respondents were asked for comments on this approach and many who have commented on the Conceptual Framework DP expressed the view that we should reconsider at least some aspects of those chapters (in particular, the treatment of prudence, reliability and stewardship).

46. The IASB will redeliberate the Conceptual Framework in the second and third quarters of 2014 with the aim of publishing an Exposure Draft of a revised Conceptual Framework by the end of 2014.

Implementation projects

Disclosure Initiative

47. This is a broad-based initiative to explore how disclosures in IFRS financial reporting can be improved. The work is informed by a Discussion Forum and related survey on Financial Reporting Disclosure that was held in January 2013. A Feedback Statement on these events was published in May 2013.

48. The Initiative is divided into short- and medium-term projects that address some of the concerns the IASB has heard and that we highlighted in the Feedback Statement.

49. As a result of one of these short-term projects, the IASB issued in March 2014 an Exposure Draft of narrow-focus amendments to IAS 1 *Presentation of Financial Statements*. The proposed amendments to IAS 1 are intended to clarify, rather than significantly change, existing requirements. It is anticipated the amendments will help to address some excessively literal interpretations of some of the guidance in IAS 1 that has resulted in problems in practice.

50. The IASB will also consider how materiality is applied in practice and consider whether further guidance is needed.

51. In the medium-term the IASB will undertake a research project to explore replacing IAS 1, IAS 7 *Statement of Cash Flows* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. As part of this work we will review the findings from the previous Financial Statement Presentation project to identify whether these findings can inform our research project.

52. In the medium term the IASB will also undertake a research project to review disclosure in existing Standards to identify and assess conflicts, duplication and overlaps.

IAS 41—Bearer Plants

53. In June 2013, the IASB published an Exposure Draft of proposals to include bearer plants within the scope of IAS 16 *Property, Plant and Equipment*. Bearer plants are a class of biological assets that, once mature, are held by an entity solely to grow produce over their productive life. Examples include grape vines, rubber trees and oil palms.

54. Currently, IAS 41 *Agriculture* requires all biological assets that are related to agricultural activity, including bearer plants, to be measured at fair value less costs to sell. This requirement is based on the principle that biological transformation is best reflected by fair value measurement. However, once mature, bearer plants no longer undergo significant biological transformation. Furthermore, their operation is similar to that of manufacturing. Consequently, the ED proposes that bearer plants should be accounted for in accordance with IAS 16 instead of IAS 41, thus permitting the use of either a cost model or a revaluation model. The produce growing on the bearer plants would remain under the fair value model in IAS 41.

55. The ED closed for comment on 31 October 2013. The IASB redeliberated the proposals in February and March 2014, discussing the main issues raised by respondents to the ED, and expects to issue the final amendments in the second quarter of 2014.

The Research Programme

56. The IASB is moving to more evidence-based standard-setting, through the whole of the development cycle for Standards. The wider IFRS community can already see examples of this shift in emphasis. The research-phase projects demonstrate the importance of understanding a financial reporting problem before resources are committed to developing new financial reporting requirements. We are also undertaking more fieldwork to assess the likely effects of new proposals—the Leases Exposure Draft is a good example. The implementation team look for evidence of diversity in practice before Interpretations are developed. The post-implementation reviews include an assessment of evidence of the observed effects of recently implemented Standards.

57. The IASB and its staff do not plan to undertake all of this research themselves. In fact, most of the research will be, or already has been, undertaken by research professionals and national standard-setters (particularly for fieldwork). Accordingly, many of our efforts have been to improve staff access to existing research and information and to encourage research professionals to undertake research that will be helpful to the IASB.

Financial Reporting research projects

58. Our research programme places much more emphasis on defining the financial reporting problem and assessing whether the IASB can make cost-effective improvements than we have done in the past. To this end, the output of the initial research will often be a Discussion Paper. The outcome will be either a decision to undertake a Standards-level project or, perhaps, a decision not to undertake any more work on that topic.

59. We have begun work on *Business combinations under common control*, *Discount rates*, *The equity method*, *Financial instruments with the characteristics of equity* and *The disclosure initiative*. We expect to take papers to public sessions of the IASB in the first half of 2014 for these projects. In addition, we expect to initiate work on *Emissions trading schemes*, and *Hyperinflation* within the next few months. In all cases we have identified national standard-setters who have an interest in working with the IASB on these projects.

60. *Intangible assets*, *Extractive activities*, *Share-based payment* and *Post-employment benefits* will be longer-term projects.

IFRS for SMEs

Comprehensive Review 2012–2014

61. As previously discussed, when the IASB issued the International Financial Reporting Standard for Small and Medium-sized Entities (*IFRS for SMEs*) in July 2009, it stated that it would undertake an initial comprehensive review of the Standard. This review would allow the IASB to assess the first two years' experience in implementing the Standard and consider whether there is a need for any amendments. In many jurisdictions, companies started using the *IFRS for SMEs* in 2010. Consequently, the IASB commenced its initial comprehensive review in 2012.

62. In order to assist in the process of identifying which items to consider for amendment, the IASB issued a Request for Information in June 2012 to seek public views and consulted with the SME Implementation Group, an advisory body to the IASB. The IASB also consulted the Advisory Council on the review of IFRS for SMEs in June 2013. After considering the feedback it had received, and taking into account the fact that the *IFRS for SMEs* is still a new Standard, the IASB proposes to make only limited amendments to the *IFRS for SMEs*. The proposed amendments are not expected to result in significant changes in practice for SMEs or to have a significant impact on their financial statements.

63. The Exposure Draft of proposed amendments to the *IFRS for SMEs* was published in October 2013 with an extended comment period of 150 days to allow organisations additional time in order to solicit and consolidate the views of smaller businesses in their jurisdictions.

Post-implementation Review (PiR)

64. In July 2013 the IASB launched its PiR of IFRS 3 *Business Combinations*. The review will include both IFRS 3 (2004) and IFRS 3 (2008) as well as all the amendments made to other Standards (eg IAS 36 *Impairment of Assets*, IAS 38 *Intangible Assets* etc) as a result of the Business Combinations project.

65. The first phase of the review will be the publication of a Request for Information (RfI). The IASB considered (in both its November and December 2013 meetings) the tentative questions to be included in the RfI. The RfI was also discussed by the Advisory Council in October 2013 and input was sought from the ASAF at its meeting in December 2013.