Summary note of the Accounting Standards Advisory Forum

Held on 2-3 June 2014 at the IASB offices, Cannon Street, London

This note is prepared by staff of the IASB, and is a high level summary of the discussion that took place. A full recording of the meeting is available on the IASB website.

ASAF members attending

Alexsandro Broedel Lopes	Group of Latin American Standard-Setters (GLASS)
Kim Bromfield	South African Financial Reporting Standards Council
Clement Chan	Asian-Oceanian Standard-Setters Group
Françoise Flores	European Financial Reporting Advisory Group
Russell Golden	Financial Accounting Standards Board (US)
Lu Jianqiao	Chinese Accounting Standards Committee
Liesel Knorr	Accounting Standards Committee of Germany
Roger Marshall	Financial Reporting Council (UK)
Ana Martinez-Pina	Instituto de Contabilidad y Auditoria de Cuentas (Spain)
Linda Mezon	Accounting Standards Board of Canada
Yukio Ono	Accounting Standards Board of Japan
Kevin Stevenson	Australian Accounting Standards Board

Disclosure Initiative

Brazilian Accounting Standards Committee Exposure Draft

1. ASAF members discussed an Exposure Draft published by the Brazilian Accounting Standards Committee on improvements to explanatory notes to the financial statements. It was explained that the Exposure Draft was issued because of the existence of irrelevant, repetitive information in the financial statements of Brazilian entities. The inclusion of this type of information in financial statements is seen as detrimental to their understandability. The purpose of the Exposure Draft is to draw attention to the existing requirements that help entities determine what information to present and disclose.

2. The Exposure Draft proposes that immaterial information should not be disclosed and that this should be enforced. This proposal drew mixed views from ASAF members:

    - One ASAF member noted their preliminary view in their draft comment letter to the IASB's Exposure Draft *Disclosure Initiative: Proposed amendments to IAS 1* is that immaterial information should not be disclosed.

    - Another ASAF member suggested that the disclosure of irrelevant information is not a problem because the information disclosed may be useful to some users. They suggested that prohibiting the disclosure of immaterial information is not operational.

EFRAG comment letter on ESMA Alternative Performance Measures Consultation Paper

3. ASAF members were provided with EFRAG's comment letter on ESMA's Consultation Paper on Alternative Performance Measures. ASAF members discussed some of the key points in that comment letter regarding alternative performance measures that are applicable to IFRS:

   - Some ASAF members, although they agreed that there needs to be transparency and consistency in the way in which alternative performance measures are reported, expressed concern about the Consultation Paper because it could encourage the disclosure of irrelevant information.

   - Some ASAF members suggested that the IASB should define some key performance indicators; for example, operating income and free cash flows.

4. ASAF members held mixed views on whether the IASB was the appropriate organisation to address non-IFRS information:

   - Some ASAF members stated that it would be difficult for the IASB to provide guidance on non-IFRS information, because of local law and enforcement of the guidance.

   - However, other ASAF members suggested that the IASB should do something; for example providing guidance on the placement of non-IFRS information. They suggested working with IOSCO and undertaking research on what guidance is available in local jurisdictions about non-GAAP measures, including what people consider to be non-GAAP measures. Those disclosures could be considered as part of the Disclosure Initiative.

5. Some ASAF members stated that if the IASB were to require the presentation of 'operating income', the scope of the alternative performance measure could be narrowed.

FASB work on disclosure

6. ASAF members discussed the FASB's work on its disclosure framework project, including the FASB's and entity's decision processes, and their potential work on financial statement presentation.

7. Some ASAF members highlighted the interaction between the Conceptual Framework project and the Disclosure Initiative: Principles of Disclosure project. Some suggested that there should be one framework for disclosures. Another suggested that some of the work from the Disclosure Initiative: Principles of Disclosure project should be incorporated into the forthcoming *Conceptual Framework* Exposure Draft.

8. One ASAF member suggested that the IASB should restart its Financial Statements Presentation project.

Equity Method of Accounting

9. The IASB staff introduced a paper that sought input from ASAF members on the scope of the research project on the equity method of accounting.

10. ASAF members generally supported the scope of the project as proposed and recommended a high level of stakeholder engagement. One member reminded ASAF that feedback to the 2011 Agenda Consultation focused on the practical difficulties in the application of the method rather than on the quality of the information that the method provided. Some ASAF members suggested that it might be useful to consider the project in two stages: (i) a short-term simplification project and (ii) a long-term conceptual review of the application of the equity method. It was, however, agreed that this would require a careful balance because it might be difficult to address simplifications if the concepts are not clear. A short-term project could address items such as:

    - goodwill;
    - impairment; and
    - accounting for the share of other net asset changes.

11. Another ASAF member suggested that the IASB should only undertake the first stage of the project, the short-term simplifications project, because they did not consider that there is sufficient evidence to support the long-term conceptual project.

12. It was noted that both EFRAG and the Korean Accounting Standards Board had recently issued papers on the equity method of accounting which will provide useful input to the project.

13. Some ASAF members noted that current practice is well understood and any proposals for changes need to factor this into consideration. Some of these members noted a concern about moving to a fair value approach. In contrast, other ASAF members suggested consideration should be given to whether the equity method was still required, given the development of IFRS 10 *Consolidated Financial Statements,* and thought a fair value approach should be considered.

14. One ASAF member stressed the importance of considering the role of the equity method in both separate and consolidated financial statements.

15. It was noted that a survey had recently been undertaken in Japan on the use of the equity method. The survey had identified that preparers thought that the equity method posed challenges in practice, but users considered that the method generally provided useful information.

16. One member recommended giving consideration to the definition of 'significant influence', although the staff paper did not propose to reconsider the definition.

Insurance Accounting

17. The IASB staff provided an update on the IASB's recent tentative decisions for non-participating contracts and sought input on the accounting for contracts with participating features.

Release of contractual service margin for non-participating contracts

18. Some ASAF members questioned the IASB's decision that the contractual service margin for non-participating contracts should be recognised in profit or loss on the basis of the passage of time. They offered examples for which the pattern of risk would not be on a straight-line basis and noted that they thought that recognising the contractual service margin on the basis of the passage of time would not always properly reflect the pattern of insurance services. However, the IASB staff explained that, in those contracts, the pattern of risk was reflected as a result of the changes in the risk adjustment, and the service covered by the contractual service margin was only the stand-ready obligation to pay valid claims. Thus, only the service of standing ready was not already reflected in other parts of the Building Block Approach. The IASB staff noted that the IASB had decided to specify the basis for recognition of the contractual service margin to avoid differing interpretations. Nonetheless, some ASAF members stated that a more principle-based approach (for example, akin to the one used for depreciation) would be preferable.

Contracts with participating features

19. The IASB staff explained that they did not plan to discuss the mirroring exception until the IASB had first decided how the tentative decisions for non-participating contracts could or should be adapted for participating contracts with respect to:
    - fulfilment cash flows;
    - adjustments for risk and the time value of money;
    - contractual service margin; and
    - presentation of the locked-in discount rate for the liability (ie in P&L or OCI).

20. The ASAF was asked the following questions:
    - Should the IASB develop a separate model for contracts with participating features? If so, what would be the principles underlying that separate model?
    - Should the entity's share of returns from underlying items unlock the contractual service margin?
    - Should there be specific requirements for options and guarantees?
      If so, how should an entity account for changes in the value of options and guarantees?

Should the IASB develop a separate model for contracts with participating features?

21. Most of the ASAF members supported a single model for all insurance contracts.

22. Another ASAF member said that there were many different products with participating features, including products with different degrees of discretion over the returns to be passed

to policyholders. That member suggested that the IASB should research the different products that could arise in various jurisdictions.

23. A few ASAF members noted support for the mirroring approach; they believed that it would be helpful for entities to depict contracts of a pass-through nature. However, other ASAF members expressed the following concerns about the mirroring exception as proposed in the 2013 ED:

- they believed that the proposed scope was too narrow;
- they believed that the proposed requirement to split cash flows into three categories would introduce unnecessary complexity; and
- they believed that the whole of the liability should be measured at current value.

24. One ASAF member noted that in their jurisdiction, other priorities had meant that the accounting for contracts with participating features had received less attention.

Should the shareholders' share of returns from underlying items unlock the contractual service margin?

25. Most ASAF members thought that changes in the shareholders' share of returns on assets should be recognised in profit or loss or OCI (depending on the measurement model for the assets), ie that the contractual service margin should not be adjusted by changes in the shareholders' share of returns on underlying items. Those ASAF members observed that:

- Unlocking the contractual service margin for shareholders' share of returns would, in substance, mean having different models for participating and non-participating contracts. A member observed that in Europe, the level of participation was greater than, for example, in the US and he could see why Europe might want a different answer.
- Unlocking the contractual service margin for changes in the shareholders' share of returns would introduce to the measurement of the insurance contract something that is not inherent in the contract.
- Unlocking would suggest that the entity has not earned the gains and losses, in spite of the fact that those gains and losses have been incurred.
- An asset management fee has quite different characteristics from a share of the change in value of an investment. In particular, an entity would still receive income from an asset management fee even if the returns on the underlying items were negative. This would not be the case for a share in the change in value of an investment.
- Because there is support for a single model for all insurance contracts, there is no more reason to apply a different accounting model for unlocking the contractual service margin than there would be for non-participating contracts, for which the changes in the shareholders' share of invested premiums would not unlock the contractual service margin.

26. However, two ASAF members supported the view that the shareholders' share of returns on assets should be treated as the entity's implicit asset management fee and that changes in the implicit asset management fee should adjust the contractual service margin. One ASAF

member said that an explicit asset management fee would be a part of the cash flows of a contract. An implicit asset management fee should be treated in the same way. However, ASAF members acknowledged that the analogy to a fee was easier to see when a large portion of the returns from underlying items were shared than for when that portion was only small, and that it could be difficult to make a non-arbitrary distinction between large and small.

27. One IASB member asked an ASAF member who supported unlocking for the shareholder share whether this would still apply if the assets were invested in an indexed fund, ie if there was no active management. The ASAF member responded that he would still unlock the contractual service margin, but he would amortise it on a different basis.

Should there be specific requirements for options and guarantees?

28. Most ASAF members did not see any reason for treating options and guarantees differently from any other component of the insurance contract. Accordingly, they would recognise changes in all cash flows, including those from options and guarantees, in profit or loss or in the contractual service margin, depending on whether they related to future service. The same discount rates would be applied as for any other cash flows.

29. One ASAF member believed that insurers would charge a fee for providing options and guarantees, and changes in the value of options and guarantees should be recognised in the same way as the fee.

30. One IASB member questioned whether there would be meaning in 'profit or loss' if the IASB were to unlock the shareholders' share of returns on assets and changes in the value of options and guarantees, and if the entity presented the unwinding of the discount on the liability in OCI. That member thought profit and loss would show only an averaged return released from the contractual service margin. One ASAF member noted that experience adjustments would be recognised in profit or loss. ASAF members generally agreed that the roll-forward of the contractual service margin would become an important part of financial statements for understanding an insurer's activity.

31. One ASAF member noted that, in spite of the IASB member's concern, the 2013 ED's proposals would already result in a substantial increase in transparency for entities that issue insurance contracts, especially in the following areas: current value measurement of liabilities; risk adjustment; and separate presentation of unearned profits. Another ASAF member said that analysts were not interested in 'noise' from investment returns; consequently, taking those returns out of profit or loss would be consistent with the analysts' view.

Macro hedging

32. The IASB staff noted that the objective of this session was to gather initial feedback from the ASAF members on the main areas of the Discussion Paper (DP) *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging*.

Assessing the need for an accounting approach, scope of the application of the portfolio revaluation approach (PRA) and other risks

33. Many members stated that the question of whether there is a need for an accounting approach for dynamic risk management (DRM) is very much related to the scope of the

project. Some members asked what the primary objective of the DP is: to solve an accounting mismatch or to reflect the risks that an entity has decided not to hedge.

34. Some members, who considered that the project's objective should be to solve an accounting mismatch, thought that the scope of the project is wider than it needs to be. One member also noted that the DP assumes that the risk of an entity is more accurately portrayed if the risk is measured at current value; however, from his point of view, this is not necessarily true. He suggested a risk can also be accurately portrayed through disclosure. He suggested identifying an alternative solution. In addition, in relation to the alternative scope of placing the focus on DRM, some members expressed concern over having to revalue the managed exposures that an entity has decided to leave unhedged.

35. One member stated that it is not clear whether the primary objective of the DP is to faithfully represent DRM activities or to reduce operational complexity. In his view, these two objectives compete with each other and it is critical for the IASB to clarify which objective it prioritises.

36. Another member stated that the DP has the potential to solve many of the operational complexities that exist today; however, he believed there is a need for a better definition of DRM to prevent opportunistic behaviours from arising.

37. There were different views on the need to fix some of the current constraints in IAS 39 to account for dynamic risk management (designation/redesignation, amortisation of hedge adjustments). In some jurisdictions banks are already dealing with the complexity posed by the current requirements in IAS 39. Consequently, they would be interested in the approach if it would allow them to consider, as accounting hedges, economic hedges that are not eligible today. Other jurisdictions, however, consider accommodating dynamic risk management with the current requirements in IAS 39 is costly (ie the continuous designation/redesignation of hedge accounting relationships) and therefore do not think that accommodating DRM to the current accounting requirements is a sound solution.

38. One member stated that the scope is too broad and that it would probably be worth considering a more simplified approach in which the focus would be on providing a solution to the operational challenges in IAS 39.

39. Another member acknowledged that the DP deals with some of the constraints in IAS 39 such as behaviouralisation, but he thinks an alternative approach to the one presented in the DP would be necessary (ie an approach that would provide an alternative that would be more like a hedge accounting solution, which would take a look at the constraints in IAS 39).

40. Another member questioned the auditability of the approach.

41. Some members mentioned that the approach would be potentially useful to commodity companies in their jurisdiction, because the current hedge accounting requirements do not meet their needs. A similar comment was made by some members in relation to the insurance industry in their jurisdiction.

42. The need for further guidance for other types of risk was mentioned by one of the members.

43. Another member stated that in her jurisdiction some constituents are very reluctant to use the approach and they think they need to have a closer look at it. That member noted that

DRM is different from accounting. Constituents are used to having restrictions in accounting and, as a result, are hesitant about the effects of depicting something differently. Constituents in that jurisdiction are following the project with interest but not much enthusiasm.

Behaviouralisation/core demand deposits

44. There was overall agreement that before going ahead with the approach, there would need to be acceptance of the consideration of behaviouralisation in general, and in particular for core demand deposits.

45. One member highlighted that what is very important in behaviouralisation is to make entities disclose what they are doing.

46. Another member highlighted that even though he agreed with the need for behaviouralisation where the primary objective is to faithfully represent DRM activities, there were significant operational concerns by preparers and auditors.

Revaluation

47. One member stated that the problem with the DP is that it made an implicit assumption that the purpose of risk management is to manage current risks. However banks' objective is to gain stability in net interest income (NII) over a period of time. From his point of view, the approach does not reflect what entities do. As a result, he would not agree with the revaluation of the exposures as considered in the PRA.

48. Another member highlighted that there are other risks that are not managed through derivatives, which the approach does not seem to consider. From her point of view, to consider risks only when they were managed through derivatives indicated that the approach in the DP was trying to solve an accounting problem rather than reflect underlying economics.

Transfer pricing transactions

49. In principle, transfer pricing transactions may provide a good representation of the managed risk; however, one should bear in mind that entities incorporate incentives in transfer pricing transactions that do not have anything to do with interest rates.

PRA through OCI

50. One member mentioned that if the objective of the approach is to reflect DRM activities faithfully, then it would be appropriate to consider OCI. If the objective is to reduce operational complexity, then it would not be necessary for the approach to consider OCI.

Conceptual Framework

The reporting of income and expenses and the choice of measurement bases

51. ASAF members discussed a paper prepared by Roger Marshall and Andrew Lennard, from the Financial Reporting Council (UK), suggesting a justification for a mixed measurement model and principles for distinguishing between profit or loss and other comprehensive income. The

authors highlight the importance of an entity's business model and of prudence when selecting measurement bases and reporting income and expense.

52. ASAF members discussed:

- the common types of business discussed in the paper—'value added' and 'price change' businesses. Many ASAF members agreed that there is a linkage between relevant measurement bases and the suggested business types. However, many participants thought that the suggested binary classification of businesses was oversimplified and would not fit more complex businesses, for example insurance companies.
- the role of business model in performance reporting and the choice of measurement bases. Some ASAF members strongly supported the view expressed in the paper that the business model or its similar notion is important in financial reporting, especially in measurement. However, one ASAF member suggested that the primary factor should not be the business model itself but the ability to change it. It was also suggested that the level at which the business model is considered is important. Should it be considered at the level of individual assets and liabilities or at a higher level?
- the proposed interpretation of prudence. Some ASAF members supported the IASB's tentative decision to consider prudence as the exercise of caution under conditions of uncertainty. However, some participants supported the authors' idea that it would be useful to clarify that prudence may lead the standard-setter, under some conditions of uncertainty, to require the earlier recognition of losses than gains (recognition asymmetry) and argued that such outcomes were already reflected in current Standards. A member noted the EFRAG-ICAS sponsored academic literature review provided evidence that users need, in circumstances of uncertainty, a lower recognition threshold for potential losses than for potential gains.
- recycling—some ASAF members supported the suggestion in the paper that items of income or expense should only be recycled from profit or loss to other comprehensive income (OCI) when doing so provides relevant information about an event in the period. However, others disagreed. Some ASAF members argued that items reported in OCI should always be required to be recycled to profit or loss, while one ASAF member suggested that there is no conceptual basis for recycling.
- the interaction between an entity's business model and complexity. In response to an IASB member who stated that consideration of an entity's business model could increase complexity, one ASAF member expressed the view that such consideration should be regarded as the source of unavoidable complexity that is necessary to achieve relevance and faithful representation in financial statements.

53. one ASAF member expressed the view that the concept of capital used in the appendix to the paper is different from the concept of capital used in the front of the paper.

Research update

54. An IASB staff member provided an update on the research programme and the current status of the projects within the programme. He noted that the research phase was about understanding the problem and exploring potential solutions. Where appropriate, this could use the resources of other standard-setters.

55. ASAF members expressed support for the programme and noted the importance of evidence-based decision-making. It was also noted that it may take time for the programme to become effective.

56. There was a discussion about how the programme fits in with the agenda consultation and how projects are selected. Some members thought that in selecting projects the IASB should explain why a project was needed, including identifying the fundamental issues that need to be addressed.

57. There was also a discussion about how the post-implementation review (PIR) feeds into the research agenda. It was noted that if the PIR gave rise to items of a maintenance nature, these would be part of the IASB's implementation and maintenance programme. In contrast, if a significant item is identified, then this could possibly give rise to further research on that. It was noted that if the research programme is working effectively then a significant item should be identified before the PIR .

58. One ASAF member asked how the programme plans to use academic research, given the complexity of standard-setting versus the methodology for academic research. It was agreed that the differing objectives between academic research and standard-setting need careful consideration and planning to ensure that the academic research can be used effectively.

Business combinations under common control

59. The IASB staff introduced a paper that sought input from ASAF members on the scope of the research project on business combinations under common control.

60. Most ASAF members believed that the scope of the project should be narrow and should focus on the most pervasive application issues—business combinations under common control and group restructurings. They noted that if the scope of the project is broad, it would probably take a long time to complete the project and would delay the issuance of the much-needed guidance. Most ASAF members specifically stated that the IASB should not consider the broader new basis issues or transfer pricing issues at this stage. They noted that the IASB could consider any further related issues in the future.

61. One ASAF member commented that, on the basis of past standard-setting experience in their jurisdiction, it would be difficult to develop a Standard without first developing some general principles for measuring all related party transactions. Setting narrow boundaries on the project would lead to debates in practice around whether the new requirements applied to certain transactions and whether those requirements should be applied to transactions outside the scope of the Standard.

62. Many ASAF members made other comments about the scope. Some ASAF members emphasised that particular attention should be given to transactions in which third parties are

involved, eg an existing or new non-controlling interest. Some ASAF members believed that the description of a 'business combination under common control' should be clarified. Some ASAF members emphasised that the IASB should not only consider accounting in the consolidated financial statements of the acquirer, but also accounting in the acquirer's separate financial statements and in the financial statements of other parties to the transaction. Other ASAF members, in contrast, believed that at this stage the IASB should focus on consolidated financial statements only of the acquirer.

Conceptual Framework

Update on the progress of the Conceptual Framework Project

63. ASAF members were provided with a summary of the tentative decisions made by the IASB in the course of redeliberations on the Conceptual Framework project.

64. Some ASAF members thought that a more in-depth discussion of the concept of 'an entity' in the *Conceptual Framework* is needed in order to resolve some complex issues currently faced by the IASB, for example, the issue of business combinations under common control.

Business model

65. The purpose of this session was to seek input from ASAF members on whether the notion of 'business model' (or a similar notion) should play a role in financial reporting, and how it can help in standard-setting.

66. ASAF members made the following comments:

- In general, ASAF members stated that the way in which an entity conducts its business activities should be considered in standard-setting. However, most participants suggested that it should be only one of the factors to consider when developing Standards that provide useful information to users of financial statements.

- Most participants stated that the way in which an entity conducts its business activities should play a role when determining measurement bases. Views varied on whether the nature of an entity's business activities should play a role in other areas, ie recognition, presentation and disclosure, distinguishing between liabilities and equity and distinguishing between profit or loss and OCI.

- Most ASAF members stated that it is not necessary to define or describe 'business model' in the *Conceptual Framework*. Many ASAF members indicated that different interpretations of the term 'business model' exist. Some ASAF members suggested that it might be better to discuss the 'nature of business activities' rather than the 'business model'.

Executory contracts

67. ASAF members discussed a paper prepared by the IASB staff that explores the nature of the assets and liabilities in executory contracts. The paper suggests that the *Conceptual Framework* should specify the nature of the assets and liabilities in executory

contracts, ie that an enforceable executory contract contains a right and an obligation to exchange resources.

68. ASAF members supported (some strongly) the development of clearer concepts on the nature of the assets and liabilities in executory contracts, particularly if those concepts would help to correct misconceptions or address issues arising in the identification and measurement of onerous contracts.

69. ASAF members expressed different views on the conceptual analysis of the assets and liabilities in executory contracts:

- some ASAF members agreed with the staff view that there is a single asset or liability to exchange resources; but
- other ASAF members thought that, conceptually, an executory contract contains both an asset and a liability (one member noting that the resources being exchanged are different). However, they did not think that Standards should require separate presentation of the asset and liability—some for practical reasons; others because they thought that there would be conceptual justifications for offsetting the asset and liability or linking their presentation.

70. ASAF members observed that many of the accounting issues that arise for executory contracts relate to measurement. However, none of the members called for measurement concepts in the *Conceptual Framework* specifically for executory contracts.

71. Other suggestions by ASAF members included:

- reconsidering the terminology, because the term 'executory contract' has a different legal definition in some jurisdictions;
- expanding the analysis to address partial performance; and
- linking the discussion of executory contracts to discussions of unit of account in the *Conceptual Framework*.

Project Update and Agenda Planning

72. IASB staff noted the project update and sought views on the proposed meeting agendas. It was noted that insurance should be added to the September agenda and that the macro-hedging discussion should be deferred from September until after the IASB has received the responses to the DP.

73. It was noted that the pension research project was included in the proposed agenda only tentatively, and depended on whether the paper was ready for discussion at the September meeting.

74. A member requested an update on the Leases project at the September 2014 meeting. It was noted that if members have views regarding this project, other than those identified by the IASB and FASB, then they should prepare written proposals for discussion.

75. The AASB noted that it would shortly be issuing an alternative to IAS 26 *Accounting and Reporting by Retirement Benefit Plans*, so the IASB might like to consider this at a future time.

76. In closing the meeting Hans Hoogervorst noted this was the last meeting for Kevin Stevenson who is retiring. Hans noted Kevin would be missed following a close association with the IASB over a number of years and that ASAF would miss Kevin's contribution.