AGENDA PAPER

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Report of the IASB Chairman

Introduction

1. I am pleased to provide a report on major developments since our last meeting in January 2014. In the period from February to December 2014 we have issued two major new Standards:

   (a) IFRS 15 *Revenue from Contracts with Customers*; and

   (b) IFRS 9 *Financial Instruments.*

2. The major new Standards, as well as major projects in our Technical Work Programme, are discussed below.

IFRS 15 Revenue from Contracts with Customers

3. The IASB issued its new revenue recognition standard, IFRS 15 *Revenue from Contracts with Customers*, in May 2014. The Standard is converged with its US GAAP equivalent, which the FASB issued concurrently with the IASB, and will be effective from January 2017. The Standard will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally.

4. Revenue is a vital metric for users of financial statements and is used to assess a company's financial performance and prospects. However, the previous requirements of both IFRS and US GAAP were different and often resulted in different accounting for transactions that were economically similar. Furthermore, while revenue recognition requirements of IFRS lacked sufficient detail, the accounting requirements of US GAAP were considered to be overly prescriptive and conflicting in certain areas.

5. Responding to these challenges, the boards have developed new, fully converged requirements for the recognition of revenue in both IFRS and US GAAP—providing substantial enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using IFRS and US GAAP.

6. The core principle of the new Standard is for companies to recognise revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new Standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements.

7. The boards have together consulted extensively with interested parties throughout the life cycle of the Revenue project, seeking public comment at each stage of the development process and further refining their proposals in response to that feedback. In total, the boards received more than 1,500 comment letters in response to their work.

8. Furthermore, the boards have established a joint transition resource group (TRG) in order to aid transition to the new Standard. The TRG informs the IASB and the FASB about potential implementation issues that could arise when companies and organisations implement the new Standard. The TRG also provides stakeholders with an opportunity to learn about the new Standard from others involved with implementation. The TRG does not issue guidance.

9. Members of the TRG include financial statement preparers, auditors and users representing a wide spectrum of industries, geographical locations and public and private companies and organisations. The TRG met twice in 2014 and is expected to meet four times in 2015. All meetings are public and are co-chaired by the Vice-Chairmen of the IASB and the FASB.

10. For the majority of the questions considered to date, the TRG's discussion has highlighted that stakeholders can understand and apply the applicable parts of the new standard. However, some of the questions have highlighted a wider range of views and, therefore, potentially greater challenges for some stakeholders in applying the standard consistently. Accordingly, the IASB will consider what, if any, action it can or should take to assist entities in these areas. In doing this the IASB will need to balance maintaining convergence with the FASB and the principle-based objective of IFRS 15.

IFRS 9 Financial Instruments

11. The IASB issued its new financial instruments standard, IFRS 9 *Financial Instruments*, in July 2014. IFRS 9 represents the final element of our response to the financial crisis. The package of improvements introduced by IFRS 9 includes a logical model for classification and measurement, a single, forward-looking 'expected loss' impairment model and a substantially-reformed approach to hedge accounting. The new Standard also addressees the issue of own credit. The new Standard will come into effect on 1 January 2018 with early application permitted.

12. Classification determines how financial assets and financial liabilities are accounted for in financial statements and, in particular, how they are measured on an ongoing basis. IFRS 9

introduces a logical approach for the classification of financial assets, which is driven by cash flow characteristics and the business model in which an asset is held. This single, principle-based approach replaces existing rule-based requirements that are generally considered to be overly complex and difficult to apply. The new model also results in a single impairment model being applied to all financial instruments, thereby removing a source of complexity associated with previous accounting requirements.

13. During the financial crisis, the delayed recognition of credit losses on loans (and other financial instruments) was identified as a weakness in existing accounting standards. As part of IFRS 9, the IASB has introduced a new, expected-loss impairment model that will require more timely recognition of expected credit losses. Specifically, the new Standard requires entities to account for expected credit losses from when financial instruments are first recognised and to recognise full lifetime expected losses on a more timely basis. The IASB has also established a transition resource group to support stakeholders in the transition to the new impairment requirements.

14. IFRS 9 introduces a substantially-reformed model for hedge accounting, with enhanced disclosures about risk management activity. The new model represents a significant overhaul of hedge accounting that aligns the accounting treatment with risk management activities, enabling entities to better reflect these activities in their financial statements. In addition, as a result of these changes, users of the financial statements will be provided with better information about risk management and the effect of hedge accounting on the financial statements.

15. IFRS 9 also removes the volatility in profit or loss that was caused by changes in the credit risk of liabilities elected to be measured at fair value. This change in accounting means that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognised in profit or loss. Early application of this improvement to financial reporting, prior to any other changes in the accounting for financial instruments, is permitted by IFRS 9.

16. Despite significant efforts, the IASB and the US Financial Accounting Standards Board (FASB) have not been able to agree a converged solution to the accounting for financial instruments. In particular, multiple attempts were made to converge on a single impairment model. However the FASB stepped away from jointly developed proposals. Efforts are now focused on supporting the consistent implementation of the new impairment requirements via the transition resource group.

Major Projects

Insurance Contracts

17. The IASB published a revised Exposure Draft (ED) *Insurance Contracts* in June 2013. That revised ED sought feedback on specific aspects of its proposals, reflecting the extensive debate the IASB has undertaken over many years, and the need to avoid further undue delay in finalising the much-needed Standard for insurance contracts.

18. During the comment period between June and October 2013, the IASB received 194 comment letters, and undertook extensive outreach and detailed field testing of the operationality of the proposals. The feedback received suggested broad support for the principle of current value measurement of insurance contracts. However, there were also significant areas of disagreement, in particular about performance reporting, and concerns about excessive complexity.

19. The IASB has been deliberating the response to the 2013 ED since January 2014. During redeliberations, the IASB has maintained extensive dialogue with all interested parties and continues to consult its advisory bodies. In particular:

    (a) The IASB has engaged extensively with preparers and other interested parties, in particular in Europe, Canada and Japan.

    (b) The IASB has sought advice from the Accounting Standards Advisory Forum (ASAF) at its March, June and September 2014 meetings.

    (c) During the third quarter of 2014, the IASB held meetings with senior representatives of insurance companies from Canada, China, France, Germany, Japan, Korea, UK and South-East Asia. The purpose of these meetings was to ensure that the IASB and staff have a clear understanding of the remaining critical issues before the IASB concludes its technical redeliberations.

    (d) In November 2014, the IASB held an education session where it considered a paper in which the European Insurance CFO Forum set out its high-level proposals for the accounting for contracts with participating features.

20. The IASB has largely concluded its tentative decisions relating to non-participating contracts. In particular the IASB has addressed each of the areas that were targeted in the 2013 ED that relate to non-participating contracts, as follows:

    (a) unlocking the contractual service margin;

    (b) recognising the effects of changes in discount rates in other comprehensive income;

    (c) insurance contracts revenue; and

    (d) transition.

21. The IASB also made tentative decisions on some specific issues that were highlighted in the feedback but that were not targeted for input. The direction that the IASB took in all these decisions was largely consistent with the feedback that it had heard on the 2013 ED.

22. The IASB continues to consider the accounting model for contracts with participating features, one of the most difficult and contentious of the specific aspects on which the IASB sought feedback. Because many of the issues to be considered by the IASB in relation to contracts with participating features are interrelated, the staff have approached these deliberations by asking the IASB for indicative leanings, rather than tentative decisions. The staff note that this process has helped the IASB and the staff to obtain feedback on the direction of the model, for the staff to consider in developing models for consideration and decision-making by the IASB.

23. As a consequence of the complexity of the issues relating to contracts with participating

features, the IASB has decided to extend its original timetable to allow it to consider the issues in detail, and to engage further with interested parties. As a result, the IASB will continue deliberations during 2015. The IASB does not expect to issue the Standard on Insurance Contracts before the end of 2015.

Leases

24. 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 and the assets it uses in its operations.

25. This is a joint project with the FASB. In May 2013, the two Boards published a joint and revised ED on leases, which, as anticipated, attracted a large number of responses—640 comment letters. Extensive outreach activities were undertaken during the comment period, focusing in particular on obtaining feedback from investors and analysts, and on understanding the drivers of costs for preparers. In addition, a series of public round tables took place.

26. The IASB had substantive discussions on the Leases project with all of its advisory bodies in February and March 2014 in preparation for the redeliberations—the IFRS Advisory Council (the 'Advisory Council'), the ASAF, the Capital Markets Advisory Council (CMAC) and the Global Preparers Forum (GPF).

27. At joint meetings between March 2014 and January 2015, the IASB and the FASB reached converged tentative decisions on almost all aspects of the project, the most important of which are as follows:

   a) 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);

   b) to measure lease liabilities on a present value basis, with simplifications made to that measurement to address concerns about cost and complexity;

   c) to distinguish a lease from a service by assessing control (see further information in the following paragraphs); and

   d) to, in essence, leave existing lessor accounting unchanged.

28. As previously reported, the Boards however have reached different conclusions on the recognition and presentation of lease expenses in a lessee's income statement.

29. In Quarter 4 of 2014, the Boards focused their discussions on the definition of a lease, which distinguishes a lease from a service. This is a critical distinction because, in the new leases Standard, it will determine whether an entity recognises assets and liabilities on its balance sheet. Although respondents were generally supportive of the proposed definition in the ED, a number of key stakeholders, particularly in Europe and Japan, raised concerns about the definition. They were of the view that the proposed definition would inappropriately capture some contracts that they view as services. The Boards considered various alternative approaches to defining a lease at their October and December 2014 joint meetings. However, the Boards concluded that these alternative approaches could have excluded substantive capital assets, such as oil rigs and ships, from an entity's balance sheet, impairing the usefulness of the financial information.

30. Accordingly, the Boards tentatively decided to reaffirm the proposed definition of a lease in the 2013 ED, but with various changes to the accompanying guidance to address requests to clarify that guidance. In essence, the Boards have tentatively concluded that a lease exists when a customer has exclusive use of an asset for a period of time, and can decide how to use it. The staff are developing a feedback document to explain the Boards' conclusions and rationale about the definition of a lease, which will complement the Leases Update that was published in August 2014.

31. The IASB has provided ASAF members with an update on the project at its meetings in June, September and December 2014.

32. It is currently expected that the IASB will complete redeliberations of the proposals in the 2013 revised ED, together with the FASB, in Quarter 1 of 2015. It is therefore expected that a life cycle review of the due process procedure will take place in Quarter 2 of 2015.

The Conceptual Framework

33. 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. It is also used by preparers to develop accounting policies when no specific Standard applies or when there is a choice of accounting policy.

34. The IASB published a Discussion Paper in July 2013 *A Review of the Conceptual Framework for Financial Reporting* with a comment period of 180 days. The IASB has considered the responses to that Discussion Paper, and other feedback received, during the development of the Exposure Draft.

35. The IASB has sought input on this project from its advisory bodies—the Advisory Council, ASAF (which is the consultative group for this project), the CMAC, and the GPF have all been consulted both during the comment period and during redeliberations.

36. The IASB's original intention was not to fundamentally reconsider the Objective and Qualitative Characteristics chapters of the *Conceptual Framework*, which were published in 2010. However, respondents were asked for comments on this approach, and many expressed the view that we should reconsider at least some aspects of those chapters (in particular, the treatment of prudence, stewardship, substance over form and reliability). Meetings were held with a number of investors to get a better understanding of their concerns and the IASB has tentatively decided:

    (a) to reintroduce an explicit reference to prudence (described as caution under conditions of uncertainty) into the *Conceptual Framework*;

    (b) to increase the prominence of references to stewardship within the description of the overall objective of financial reporting; and

    (c) not to reinstate the term 'reliability' to describe one of the two fundamental qualitative characteristics of useful financial information[1]. The existing *Conceptual Framework* now uses the term 'faithful representation' to refer to that concept, and describes it in a manner largely similar to the discussion of 'reliability' in the previous version of the *Conceptual Framework*. In addition, the IASB now proposes to clarify how the level of estimation uncertainty associated with an asset or liability affects recognition and measurement.

37. Some respondents to the Discussion Paper expressed the view that the Conceptual Framework is under-developed in specific areas (in particular, the distinction between liabilities and equity, measurement and the presentation of items of income or expense in other comprehensive income (OCI)). The IASB discussed these concerns but decided not to undertake significant additional research work on measurement and the use of OCI at this stage. The IASB has a research project *Financial Instruments with Characteristics of Equity*, which could result in amendments to the revised Conceptual Framework.

38. The IASB has now finalised redeliberations. At its October 2014 meeting, the IASB confirmed that it is satisfied that sufficient due process steps have been undertaken and instructed the staff to begin the balloting process on the ED.

39. It is anticipated the ED will be published in quarter 1 2015. At its meeting in October 2014 the IASB considered the comment period for the ED. The IASB agreed on a longer comment period than the normal comment period of 120 days and the ED will be open for comment for a period of 150 days.

Disclosure Initiative

40. The Disclosure Initiative is a portfolio of projects being undertaken with the aim of improving the effectiveness of disclosures in financial reporting. The work is informed by a Discussion Forum that was held in January 2013, and related survey on Financial Reporting Disclosure. A Feedback Statement on these events was published in May 2013.

41. The Disclosure Initiative portfolio of projects includes both implementation and research projects. The implementation projects include:

    a) Narrow-focused amendments to IAS 1 Presentation of Financial Statements; and

    b) Narrow-focused amendments to IAS 7 Statement of Cash Flows.

42. The research projects include:

    a) Principles of Disclosure – review of IAS 1, IAS 7 and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors;

    b) Materiality; and

    c) Review of disclosures in existing Standards.

43. In December 2014 the IASB issued amendments to its disclosure requirements that are designed to encourage companies to apply professional judgement in determining what information to disclose in their financial statements and where and in what order information is presented. This responds to concerns that, as previously worded, the IFRS requirements

[1] The other fundamental qualitative characteristic is relevance.

were considered by some to be too prescriptive.

44. Also on 18 December 2014 the IASB published an exposure draft (ED) Disclosure Initiative Amendments to IAS 7. The objectives of the proposed amendments are to improve:

a) information provided to users of financial statements about an entity's financing activities, excluding equity items; and

b) disclosures that help users of financial statements to understand the liquidity of an entity.

45. In developing the ED a survey was undertaken with investors to identify why investors seek to understand debt, including changes in debt during the reporting period. The CMAC was consulted in October 2013 and the draft proposals discussed at the joint CMAC and GPF meeting in June 2014. Further input was sought from the GPF in quarter 3 of 2014. The Exposure Draft was issued for comment for a period of 120 days ending 17 April 2015.

46. The Principles of Disclosure project is the cornerstone of the Disclosure Initiative. Its objective is to improve disclosures in financial statements by identifying and developing a set of principles for disclosure in IFRS. The project's aim is to set the basis for replacing the disclosure requirements in: IAS 1, IAS 7 and IAS 8. The project may also affect the review of disclosure requirements and guidance in other IFRSs.

47. The IASB agreed the scope of the project in April 2014 and has discussed the project regularly during 2014. Advice on specific topics was sought from the ASAF at its meetings in December, September and June 2014. In addition advice has been sought from GPF and CMAC during 2014. The IASB aims to published a Discussion Paper in quarter 2 of 2015, although this will depend on how discussions progress.

48. As regards materiality, the IASB has conducted outreach with national and regional standard-setters regarding local guidance and practice. As well as speaking to ASAF, GPF, World Standard Setters, the Advisory Council, International Organization of Securities Commissions (IOSCO) and the International Auditing and Assurances Standards Board (IAASB) about how materiality is applied in practice and the need for potential guidance.

49. During the third quarter of 2014 the IASB decided to develop guidance on the application of materiality, which would take the form of a Practice Statement. It postponed a decision on how to deal with different terminology relating to the use of materiality within the Standards until the further work on the disclosure requirements in existing Standards has been completed. The IASB plans to expose for public comment a [draft] Practice Statement in the second quarter of 2015.

50. The IASB is aware of the sensitivity of this topic because in some jurisdictions materiality is considered to be the responsibility of the securities regulator and the courts. The staff have been liaising with securities regulators for that reason and we are confident that we can develop helpful, non-mandatory, guidance that works globally.

51. The IASB is also undertaking a research project to review disclosure in existing Standards to identify and assess conflicts, duplication and overlaps.

Research projects

52. The IASB has eight high-priority projects, three medium-priority projects and four longer-

term projects. Although this may seem like a large pool of projects, we envisage that some of these projects will be completed quickly and will not lead to standard-setting activity. They also vary in size and complexity, which means that they will reach major milestones (a Research Paper or Discussion Paper) at different times.

53. The high-priority projects are:

a) The Disclosure Initiative; see the update above;

b) Rate-regulated Activities;

c) Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging;

d) Financial Instruments with Characteristics of Equity;

e) Business Combinations under Common Control;

f) Equity Method of Accounting;

g) Discount Rates; and

h) High Inflation.

54. We also have a number of medium-priority and longer-term projects which are at varying stages.

Evidence-informed Standard-setting

55. Part of our efforts has been focused on building our research capability and our interactions with the broader research community. Among the steps we have taken this year are:

(a) we hired a research resource manager to look after our resources and help staff to access information;
(b) we established an internal Research Portal, which gives us access to academic and professional research, business articles, financial statement data and some economic data;
(c) we established a new Research Centre (IFRS Research Centre) aimed at academics and other research professionals;
(d) we published our first Research Roundup. We are aiming to publish a new issue every six months; and
(e) we started to receive applications from academics for research fellowships.

56. These steps are aimed at increasing our ability to assimilate research. We are helping staff and IASB members to become more aware of how independent research can inform and support their decisions, as well as the pitfalls.

57. We are engaging positively with the broader research community. The IAAER and the European Association, both of which have representatives on the Advisory Council, have been helpful and supportive in this process.

Effects analysis

58. The Effects Analysis Consultative Group was formed in 2013 in response to the Trustees' strategic plan and held its first meeting in May 2013. The purpose of establishing the Consultative Group was to identify best practice in the assessment of the likely effects of a new Standard and, in doing so, to seek to enhance the confidence in, and efficiency of, the processes.

59. The Consultative Group published its report in November 2014. The report identified a series of recommendations related to general purpose financial reports, fieldwork and the reporting of likely effects. The Trustees will work with the IASB to implement the recommendations of the Consultative Group, which will further embed effects analyses within the IASB's due process.

60. The recommendations build upon our already extensive methodology for undertaking effects analysis. It is important that this work enjoys the confidence of our stakeholders. We therefore intend to implement the recommendations in full.