

STAFF PAPER

July 2015

IASB Meeting

Project	Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging		
Paper topic	Due process		
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Background

1. The Discussion Paper ‘*Accounting for Dynamic Risk Management – a Portfolio Revaluation Approach to Macro Hedging*¹’ (hereafter ‘2014 DP’) was the IASB’s first step in developing an accounting model for dynamic risk management (hereafter ‘DRM’). During February and March 2015 the IASB discussed the high level feedback received from comment letters and outreach activities on the 9 sections covering 26 questions included in the 2014 DP.
2. The Due Process Handbook (hereafter ‘Handbook’) requires that Discussion Papers and Research Papers typically include a comprehensive overview of the issues, possible approaches to addressing the issue, the preliminary views of its authors or the IASB and an invitation to comment.
3. Discussion Papers are meant to assist the IASB in evaluating the merits of adding a potential item to its work programme primarily on the basis of the needs of users of financial reports (hereafter ‘users’), while also taking into account the costs of preparing the information in financial reports. When deciding whether a proposed agenda item will address users’ needs, the IASB considers:

¹ <http://www.ifrs.org/Current-Projects/IASB-Projects/Financial-Instruments-A-Replacement-of-IAS-39-Financial-Instruments-Recognitio/Phase-III-Macro-hedge-accounting/DP-April-2014/Documents/Discussion-Paper-Accounting-for-Dynamic-Risk-Management-April-2014.pdf>

- (a) whether there is a deficiency in the way particular types of transactions or activities are reported in financial reports;
 - (b) the importance of the matter to those who use financial reports;
 - (c) the types of entities likely to be affected by any proposals, including whether the matter is more prevalent in some jurisdictions than others; and
 - (d) how pervasive or acute a particular financial reporting issue is likely to be for entities.
4. In May 2012, the IASB discussed the benefits of publishing a Discussion Paper rather than an Exposure Draft. Those benefits included the fact that a Discussion Paper would allow the IASB to elicit views not only on the proposed model ie the Portfolio Revaluation Approach (hereafter ‘PRA’), which in itself was an entirely new approach but also on a broader range of accounting alternatives. It was also noted that a Discussion Paper is a more suitable means of gathering stakeholders’ opinions on critical questions such as the scope of the PRA and the usefulness of accounting information, including the trade-off between reflecting risk management strategies and enhancing comparability among entities.
5. Many respondents to the 2014 DP agreed that there was a need for a project to address the limitations of current IFRS accounting requirements when applied to DRM scenarios. They noted that the 2014 DP had broadly captured the key characteristics of DRM. Furthermore, they commented that the 2014 DP had succeeded in identifying the challenges presented by open portfolios and in comprehensively analysing issues such as behaviouralisation and deemed exposures. Users and preparers also provided valuable feedback about critical aspects of the project which are expected to be particularly complex and challenging to address. However, the feedback received also highlighted significant diversity in the views among the stakeholders regarding the objectives of the project.
6. In considering the above feedback and in particular the challenges identified, the IASB acknowledged during their meeting in May 2015, that any solution would need to consider the information needs of constituents. Furthermore, the IASB acknowledged that its approach should consider disclosures, recognition and

measurement in order to arrive at a consistent set of proposals to address those needs. At that meeting the IASB also tentatively decided that it should firstly consider how the information needs of constituents concerning DRM activities could be addressed through disclosures before considering those areas that need to be addressed through recognition and measurement.

Staff recommendation

7. While the 2014 DP was successful in terms of gathering views of respondents and confirming the need for the project, the staff also note the significantly conflicting messages which were received from stakeholders regarding the objectives of the project (as noted in the February and March 2015 IASB meetings). The staff think that the insights that the IASB received from comments and feedback to the 2014 DP is not necessarily sufficient for the IASB to move on to an Exposure Draft of a proposed Standard. As a result, although the staff consider that there is a strong mandate to develop an accounting model for DRM activities in IFRS financial statements, we do not consider that the IASB should move on to an Exposure Draft without conducting further research and consultation.
8. Consequently, the staff recommend that at this juncture the project remains in the Research Programme, instead of transferring to the Standards Agenda. This means that the staff will aim to publish a second Discussion Paper before developing proposals for exposure as a final Standard (ie before publishing an Exposure Draft).
9. At the same time, however, the staff also recommend that the IASB does not close the possibility to move directly on an Exposure Draft at this stage.
10. The following paragraphs explain the staff's reasoning for the above recommendations.

Basis of staff recommendation

11. The staff consider that there are two primary benefits to be gained by publishing a second Discussion Paper before progressing to an Exposure Draft of a proposed Standard.

- (a) A second Discussion Paper is likely to facilitate a more effective consultation rather than an Exposure Draft which needs to set out a specific proposal in the form of proposed Standard. As noted in paragraph 5, feedback received on the 2014 DP identified significant diversity in the views among stakeholders regarding the objectives of the project. A second Discussion Paper will allow the IASB to explore these differences in greater detail prior to moving on to an Exposure Draft.
 - (b) As noted in paragraph 6, the IASB made a tentative decision in May 2015 to approach the project by considering how the information needs of stakeholders could be addressed through disclosures before considering those areas that need to be addressed through recognition and measurement. One of the reasons behind the decision was its flexibility in aligning the needs of various stakeholders. In light of this, the staff believe that it would be more appropriate to consider a second Discussion Paper which will allow the IASB to capitalise on the flexibility that is inherent in such an approach. There is a possibility that new accounting approaches that enable entities to more faithfully represent their DRM activities may emerge through the process of re-deliberation.
12. In addition the staff anticipate a number of other benefits of publishing a second Discussion Paper, including:
- (a) Clearer understanding of the proposed accounting model and how it reflects the financial effects of DRM of interest rate risk;
 - (b) Better opportunities for field testing in the development stage - given the complexities involved during the development of any proposed model, the staff will seek assistance from stakeholders through consultation and field testing of various approaches. A second Discussion Paper will provide an opportunity to explain what alternatives have been considered and why various elements of the proposed model have been selected over other alternatives;
 - (c) Reduced risks of significant changes to the model proposed in the subsequent Exposure Draft—providing stakeholders with proposals based

around a more complete and robust model in a subsequent Exposure Draft should minimise the need for substantive changes to the model after the Exposure Draft stage. This is because both the principles underpinning the proposed model and the operability of the model will have been more thoroughly tested through the second Discussion Paper phase.

13. The staff do not envisage that this will slow down the completion of the project. If the decision is taken to move on to an Exposure Draft without the appropriate level of consultations which would provide the IASB with a sufficient degree of confidence that the proposals in the Exposure Draft would be supported by a wide range of stakeholders, it is possible that substantial changes to the proposals would be required after the Exposure Draft. Furthermore, as an Exposure Draft needs to set out a specific proposal in the form of proposed Standard, any changes in the proposed models would be more difficult to address than changes to a proposed model set out in a Discussion Paper. This could result in *more* time being needed for the completion of the project, if the decision is taken to move directly on to an Exposure Draft.
14. At the same time, however, the staff also recommend that the IASB does not close the possibility to move directly on an Exposure Draft at this stage. As mentioned, the comments received on the 2014 DP as well as the outreach dialogues have provided a useful, albeit not a complete, insight into the information needs of users as well as preparers. In the second Discussion Paper, the staff will try to narrow down the proposals to those that are believed to be the most faithful representation of entities engaged in DRM activities. If it is observed that a solution that addresses the issues regarding a set of disclosures, recognition and measurement requirements emerge, the staff would want to ask the IASB at that juncture whether it is appropriate to move directly on to an Exposure Draft.

Question to the IASB

Question

Does the IASB agree with the staff recommendations outlined in paragraph 7 to 9?

