STAFF PAPER

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IASB Meeting

Project	**Different effective dates of IFRS 9 and the new insurance contracts Standard**
Paper topic	Applicability of the Deferral and Overlay Approaches for first-time adopters of IFRS

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Introduction

1. If the proposals in the forthcoming Exposure Draft (ED) of amendments to IFRS 4 *Insurance Contracts* (IFRS 4) are confirmed,

   (a) the Overlay Approach will be available to entities that first apply IFRS 9 *Financial Instruments* (IFRS 9) before the new insurance contracts Standard is effective. The mandatory effective date of IFRS 9 is for annual periods beginning on or after 1 January 2018 and an entity may early apply IFRS 9.

   (b) the Deferral Approach will be available for annual periods that begin before 1 January 2021 provided that the new insurance contracts Standard is not yet effective.

2. An entity would be permitted to apply the Overlay Approach and Deferral Approach only if it had not previously applied IFRS 9.

3. If confirmed, the Overlay Approaches would be relevant to a first-time adopter preparing their first IFRS financial statements in reporting periods after the amendments to IFRS 4 are issued (ie late 2016), if the entity choses to early adopt IFRS 9. Both approaches would be relevant for first-time adopters in periods after IFRS 9 is effective. The Overlay Approach would also be relevant to first-time adopters who early apply IFRS 9 before its mandatory effective date.

4. This paper considers whether entities that will prepare their first IFRS financial statements (ie first-time adopters of IFRS) should be permitted to apply those two approaches.

5. This paper does not consider a first-time adopter that prepares its first IFRS financial statements using IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) for reporting periods that end before 1 January 2018. Such entities would no longer be first-time adopters when IFRS 9 and the new insurance contracts Standard are effective. Accordingly, a first-time adopter that prepares its first IFRS financial statements using IAS 39 will be allowed to use the Deferral and Overlay approaches when it prepares financial statements in subsequent periods.

Staff recommendation

6. The staff recommends that a first-time adopter of IFRS should be prohibited from applying the Deferral and Overlay approaches.

Staff analysis

7. The staff considered whether the Deferral and Overlay approaches should be permitted for first-time adopters.

8. Some observe that if first-time adopters were permitted to apply the Overlay and Deferral approaches, few (if any) entities might actually apply those approaches. Both proposed approaches are optional and the costs of applying them for entities that had not previously applied IAS 39 would likely be more than applying IFRS 9 in full. This is because the application of both the Overlay and Deferral approaches require information that would result from applying IAS 39, in part or in full. First-time adopters are unlikely to have applied requirements that are similar or identical to IAS 39 before preparing their first set of IFRS financial statements. Thus, applying the Overlay or Deferral approaches would require that the first-time adopter applies IAS 39 on first-time application of IFRS, at least in part, in addition to IFRS 9. Consequently, the outcome of permitting first time

adopters to apply the Deferral or Overlay approaches may be the same as if those approaches were prohibited.

9. However, the staff concluded that first-time adopters should be prohibited from applying both of those approaches, because:

    (a) those approaches are unlikely to be relevant to first-time adopters. This is discussed in paragraphs 10-11; and

    (b) prohibiting those approaches would be consistent with the IASB's underlying concepts in IFRS 1 *First-time Adoption of International Financial Reporting Standards* (IFRS 1). This is discussed in paragraphs 12-17.

Unlikely to be relevant to first-time adopters

10. The staff think that the Deferral and Overlay approaches are unlikely to be relevant to first-time adopters, because:

    (a) those approaches are proposed to respond to concerns raised on the temporary accounting consequences that could arise when an entity makes the transition from IAS 39 to IFRS 9 on a different date than when the entity first applies the new insurance contracts Standard.

    (b) first-time adopters will be making the transition from previous national financial reporting requirements to IFRS 9, rather than from IAS 39 to IFRS 9.

11. In addition, first-time adopters would be reviewing all their accounting policies, including those for insurance contracts, and are likely to consider requirements that are effective in the near future. The first-time adopters considered in this paper could consider avoiding any accounting mismatches of applying IFRS 9 before the new insurance contracts Standard by:

    (a) using accounting policies that are consistent with the requirements of the new insurance contracts Standard; or

    (b) early adoption of the new insurance contracts Standard, when it is available for early adoption.

Consistent with concepts of IFRS 1

12. In evaluating whether to prohibit the Deferral and Overlay approaches for first-time adopters, the staff also considered the basic concepts underlying IFRS 1, which are described in paragraphs BC7-BC15 of the Basis for Conclusions for that Standard as follows:

    (a) requiring first-time adopters to apply the current version of IFRSs; and

    (b) enhancing comparability within an entity over time; and between first-time adopters and entities that have already adopted IFRS.

    Those paragraphs refer to the qualitative characteristics (in particular comparability) that make the information in financial statements useful and discuss how those characteristics should be considered within the context of first-time adopters. These paragraphs are reproduced in Appendix A.

Current version of IFRSs

13. The staff recommend that first-time adopters should be prohibited from applying the Deferral and Overlay approaches, because those approaches would effectively allow first-time adopters to apply in part, or in full, the requirements of IAS 39 after the mandatory effective date of IFRS 9. Instead, consistent with the underlying concepts of IFRS 1, the staff think first-time adopters should be required to apply the requirements of IFRS 9 in full as soon as IFRS 9 is effective (or earlier if an entity has chosen to apply it early). Staff note that paragraph BC11 of IFRS 1 explains that IFRS 1 requires a first-time adopter to apply the current version of IFRSs, without considering superseded or amended versions in order to:

    (a) give users comparative information prepared using later versions of IFRSs that the Board regards as superior to superseded versions; and

    (b) avoid unnecessary costs.

Comparability

14. Paragraph BC9 of IFRS 1 notes the emphasis that the IASB has placed on comparability:

    (a) within an entity over time; and

(b) between first-time adopters and entities that have already adopted IFRS.

15. Paragraph BC14 of IFRS 1 indicates that the IASB considers that the objective of comparability over time within a first-time adopter's first IFRS financial statements is achieved when a first-time adopter applies the current version of IFRSs and applies those requirements retrospectively. Accordingly, a first-time adopter would achieve the objective of comparability over time by applying IFRS 9 in full, even in the periods before IFRS 9 is effective (if the entity choses to early apply it).

16. The staff note that applying IFRS 9 in full instead of applying either the Deferral or Overlay approaches would not make first-time adopters any less comparable with existing IFRS preparers. This is because both of those proposed approaches are optional, and thus comparability between entities is already impaired. That impaired comparability is the reason that the IASB has proposed disclosures about the characteristics of financial assets to accompany the Deferral Approach and at minimum a line item of the adjustment on the face of the statement of comprehensive income for the Overlay Approach.

17. In addition, first-time adopters will be in the same position as existing IFRS preparers that have applied IFRS 9 in full before the new insurance contracts Standard. When the new insurance contract Standard is effective, those entities will no longer be first-time adopters. Accordingly, the transition reliefs relating to financial assets when the entity later applies the new insurance contracts Standard (discussed in Agenda paper 2A at this meeting) will also be available to those entities.

Question to the IASB: first-time adopters of IFRS
Does the IASB agree that a first time adopter of IFRS should be prohibited from applying the Deferral and Overlay approaches?

Appendix A—Excerpt from Basis for Conclusions for IFRS 1 *First-time Adoption of International Financial Reporting Standards*

A1. This appendix contains paragraphs BC7-BC15 of IFRS 1.

Basic concepts

Useful information for users

BC7 In developing recognition and measurement requirements for an entity's opening IFRS balance sheet, the Board referred to the objective of financial statements, as set out in the *Framework for the Preparation and Presentation of Financial Statements*. The *Framework*[2] states that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

BC8 The *Framework* identifies four qualitative characteristics that make information in financial statements useful to users. In summary, the information should be:

(a) readily understandable by users.

(b) relevant to the decision-making needs of users.

(c) reliable, in other words financial statements should:

(i) represent faithfully the transactions and other events they either purport to represent or could reasonably be expected to represent;

(ii) represent transactions and other events in accordance with their substance and economic reality and not merely their legal form;

(iii) be neutral, that is to say, free from bias;

(iv) contend with the uncertainties that inevitably surround many events and circumstances by the exercise of prudence; and

(v) be complete within the bounds of materiality and cost.

(d) comparable with information provided by the entity in its financial statements through time and with information provided in the financial statements of other entities.

Comparability

BC9 The previous paragraph notes the need for comparability. Ideally, a regime for first-time adoption of IFRSs would achieve comparability:

(a) within an entity over time;

(b) between different first-time adopters; and

(c) between first-time adopters and entities that already apply IFRSs.

BC10 SIC-8 gave priority to ensuring comparability between a first-time adopter and entities that already applied IASs. It was based on the principle that a first-time adopter should comply with the same standards as an entity that already applied IASs. However, the Board decided that it is more important to achieve comparability over time within a first-time adopter's first IFRS financial statements and between different entities adopting IFRSs for the first time at a given date; achieving comparability between first-time adopters and entities that already apply IFRSs is a secondary objective.

Current version of IFRSs

BC11 Paragraphs 7–9 of the IFRS require a first-time adopter to apply the current version of IFRSs, without considering superseded or amended versions. This:

(a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;

(b) gives users comparative information prepared using later versions of IFRSs that the Board regards as superior to superseded versions; and

(c) avoids unnecessary costs.

BC12 In general, the transitional provisions in other IFRSs do not apply to a first-time adopter (paragraph 9 of the IFRS). Some of these transitional provisions require or permit an entity already reporting in accordance with IFRSs to apply a new requirement prospectively. These provisions generally reflect a conclusion that one or both of the following factors are present in a particular case:

(a) Retrospective application may be difficult or involve costs exceeding the likely benefits. The IFRS permits prospective application in specific cases where this could occur (paragraphs BC30–BC73).

(b) There is a danger of abuse if retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known. The IFRS prohibits retrospective application in some areas where this could occur (paragraphs BC74–BC84).

BC13 Some have suggested three further reasons for permitting or requiring prospective application in some cases:

(a) to alleviate unforeseen consequences of a new IFRS if another party uses financial statements to monitor compliance with a contract or agreement. However, in the Board's view, it is up to the parties to an agreement to determine whether to insulate the agreement from the effects of a future IFRS and, if not, how they might renegotiate it so that it reflects changes in the underlying financial condition rather than changes in reporting (paragraph 21 of the *Preface to International Financial Reporting Standards*).

(b) to give a first-time adopter the same accounting options as an entity that already applies IFRSs. However, permitting prospective application by a first-time adopter would conflict with the Board's primary objective of comparability within an entity's first IFRS financial statements (paragraph BC10). Therefore, the Board did not adopt a general policy of giving first-time adopters the same accounting options of prospective application that existing IFRSs give to entities that already apply IFRSs. Paragraphs BC20–BC23 discuss one specific case, namely derecognition of financial assets and financial liabilities.

(c) to avoid difficult distinctions between changes in estimates and changes in the basis for making estimates. However, a first-time adopter need not make this distinction in preparing its opening IFRS balance sheet, so the IFRS does not include exemptions on these grounds. If an entity becomes aware of errors made under previous GAAP, the IFRS requires it to disclose the correction of the errors (paragraph 26 of the IFRS).

BC14 The Board will consider case by case when it issues a new IFRS whether a first-time adopter should apply that IFRS retrospectively or prospectively. The Board expects that retrospective application will be appropriate in most cases, given its primary objective of comparability over time within a first-time adopter's first IFRS financial statements. However, if the Board concludes in a particular case that prospective application by a first-time adopter is justified, it will amend the IFRS on first-time adoption of IFRSs. As a result, IFRS 1 will contain all material on first-time adoption of IFRSs and other IFRSs will not refer to first-time adopters (except, when needed, in the Basis for Conclusions and consequential amendments).

BC15 Under the proposals in ED 1, a first-time adopter could have elected to apply IFRSs as if it had always applied IFRSs. This alternative approach was intended mainly to help an entity that did not wish to use any of the exemptions proposed in ED 1 because it had already been accumulating information in accordance with IFRSs without presenting IFRS financial statements. To enable an entity using this approach to use the information it had already accumulated, ED 1 would have required it to consider superseded versions of IFRSs if more recent versions required prospective application. However, as explained in paragraphs BC28 and BC29, the Board abandoned ED 1's all-or-nothing approach to exemptions. Because this eliminated the reason for the alternative approach, the Board deleted it in finalising the IFRS.