Conference Documentation

IFRS Foundation

IFRS Conference: Amsterdam

2013

A one-and-a-half-day conference for senior financial executives and other interested parties
THE NETHERLANDS
International Financial Reporting Standards (IFRSs) Conference
Thursday 27 and Friday 28 June 2013—NH Grand Krasnapolsky in Amsterdam (The Netherlands)
A one-and-a-half-day conference for senior financial executives and other interested parties

Day 1—Thursday 27 June 2013

Special Interest Sessions (pre-conference)

09:00 Registration

09:30–12:00 Register for one of:
- Investor-focused IFRS update
- Implementing forthcoming Financial Instruments requirements
- Implementing forthcoming Revenue Recognition requirements
- Implementing IFRS 10 Consolidated Financial Statements and IFRS 12 Disclosure of Interests in Other Entities

Conference Programme

12:00 Registration
Light buffet and refreshments

13:00 The future of financial reporting
Hans Hoogervorst, Chairman, IASB

13:30 IASB update
- Major IFRSs
- Implementation
- Conceptual Framework
- Research projects

Chair: Hans Hoogervorst, Chairman, IASB

Presenters:
- Stephen Cooper, Member, IASB
- Philippe Danjou, Member, IASB
- Wayne Upton, Chairman, IFRS Interpretations Committee and Director of International Activities, IASB
- Sue Lloyd, Senior Director, Technical Activities, IASB
- Alan Teixeira, Senior Director, Technical Activities, IASB

15:00 Coffee break
15:30 IASB update (continued)

17:15 Keynote address
Klaas Knot, President, De Nederlandsche Bank (the Dutch Central Bank)

18:00–19:00 Cocktail reception
09:00  **Technical update: financial instruments**  
*Chair: Hans Hoogervorst, Chairman, IASB*

Replacement of IAS 39, including:
- Classification and measurement: **Sue Lloyd**, Senior Director, Technical Activities, IASB
- Impairment: **Stephen Cooper**, Member, IASB
- Hedge accounting: **Martin Edelmann**, Member, IASB

11:00  **Coffee break**

11:30  **Break-out sessions:**
*conducted by IASB members and staff*

Choose **one** of the following – the sessions are repeated after lunch so you can attend two sessions:

1. **Financial Instruments: macro hedge accounting**
   - Martin Edelmann, Member, IASB
   - Jane Hurworth, Practice Fellow, IASB

2. **Leases**
   - Philippe Danjou, Member, IASB
   - Patrina Buchanan, Technical Principal, IASB
   - Sarah Geisman, Technical Manager, IASB

3. **Rate regulated activities**
   - Stephen Cooper, Member, IASB
   - Jane Pike, Senior Technical Manager, IASB

4. **Conceptual Framework (Part 1): presentation and disclosure (including XBRL)**
   - Takatsugu Ochi, Member, IASB
   - Peter Clark, Director of Research, IASB
   - Kristy Robinson, Technical Principal, IASB

13:00  **Lunch**

14:00  **Break-out sessions:**
*conducted by IASB members and staff*

Choose **one** of the following:

1. **Financial Instruments: Impairment**
   - Martin Edelmann, Member, IASB
   - Sue Lloyd, Senior Director, Technical Activities, IASB
   - Riana Wiesner, Senior Technical Manager, IASB

2. **Leases**
   - Philippe Danjou, Member, IASB
   - Patrina Buchanan, Technical Principal, IASB
   - Sarah Geisman, Technical Manager, IASB

3. **Implementation update**
   - Wayne Upton, Chairman, IFRS Interpretations Committee and Director of International Activities, IASB

4. **Insurance Contracts**
   - Stephen Cooper, Member, IASB
   - Andrea Pryde, Technical Principal, IASB
   - Izabela Ruta, Assistant Technical Manager, IASB
   - Andrea Silva, Technical Associate, IASB

5. **Conceptual Framework (Part 2): elements and measurement**
   - Takatsugu Ochi, Member, IASB
   - Peter Clark, Director of Research, IASB
   - Kristy Robinson, Technical Principal, IASB

15:30  **End of conference**
# Investor-focused IFRS Update

To assist the investor and analyst communities to prepare for the effects of new and amended IFRSs that become effective for the first time in 2013, the IFRS Foundation will hold an intensive half-day session immediately before the IFRS conference, on the morning of 27 June 2013. This session will also be useful to investor relations personnel who communicate changes in accounting requirements to investors and analysts.

In this session:
- an IASB member will summarise particular new IFRS principles;
- an analyst will explain how the new information affects their ability to analyse financial information; and
- a preparer will demonstrate how they are communicating the changes to investors and analysts.

A panel will then discuss the effects of the changes on financial analysis and valuation.

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<thead>
<tr>
<th>Time</th>
<th>Activity</th>
<th>Presenter</th>
<th>Role</th>
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<tbody>
<tr>
<td>09:00</td>
<td>Registration and refreshments</td>
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<tr>
<td>09:30</td>
<td>Introduction</td>
<td>Patrick Finnegan</td>
<td>Member IASB</td>
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<tr>
<td>09:35</td>
<td>Panel discussion and Q&amp;A</td>
<td>Chair—Patrick Finnegan</td>
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<td>Panelists:</td>
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<td>Stephen Cooper, Member, IASB</td>
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<td>Patricia McConnell, Member, IASB</td>
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<td>Barbara Davidson, Principal, Investor Liaison, IASB</td>
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<td>Dennis Jullens, Lecturer, Researcher, Valuation &amp; Accounting, Rotterdam School of Management, Erasmus University formerly European Head, Valuation &amp; Accounting Research, UBS Investment Bank</td>
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<td>Peter Joos, Global Head of Valuation &amp; Accounting, Morgan Stanley Research</td>
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<td>Topics:</td>
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<td></td>
<td>Removal of the corridor method for pensions (IAS 19)</td>
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<td>New disclosures—unconsolidated structured entities and disclosures of risks associated with interests in other entities (IFRS 12); fair value disclosures (IFRS 13); and offsetting financial instruments (IFRS 7)</td>
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<td>Consolidation—control and investment entities (IFRS 10)</td>
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<td>Removing proportionate consolidation (IFRS 11)</td>
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<td>Presentation of other comprehensive income (IAS 1) including changes in “own credit” risk (IFRS 9)</td>
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<tr>
<td>11:55</td>
<td>Concluding comments</td>
<td>Patrick Finnegan</td>
<td>Member IASB</td>
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<td>12:00</td>
<td>Close session</td>
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# Implementing forthcoming Financial Instruments requirements

To assist you to prepare for the implementation of IFRS 9 Financial Instruments, the IFRS Foundation will hold an intensive half-day session immediately before the IFRS conference, on the morning of 27 June 2013.

<table>
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<td>09:30</td>
<td>Introduction</td>
<td>Martin Edelmann</td>
<td>Member IASB</td>
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<tr>
<td>09:35</td>
<td>IFRS 9 Financial Instruments</td>
<td>Riana Wiesner</td>
<td>Senior Technical Manager IASB</td>
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<tr>
<td>10:15</td>
<td>Hedge Accounting</td>
<td>Martin Friedhoff</td>
<td>Executive Director Ernst &amp; Young</td>
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<td>10:45</td>
<td>Operationalising Impairment proposals</td>
<td>Bill Hayward</td>
<td>Director Barclays</td>
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<td>11:15</td>
<td>Round-table Q&amp;A</td>
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<tr>
<td>11:55</td>
<td>Concluding comments</td>
<td>Martin Edelmann</td>
<td>Member IASB</td>
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<td>12:00</td>
<td>Close session</td>
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IFRS Foundation: Special Interest Sessions
Morning of Thursday 27 June 2013—NH Grand Krasnapolsky in Amsterdam (The Netherlands)

Implementing forthcomin
Revenue Recognition requirements

To assist you to prepare for the implementation of forthcoming IFRS—Revenue Recognition, the IFRS Foundation will hold an intensive half-day session immediately before the IFRS conference, on the morning of 27 June 2013.

09:00 Registration and refreshments

09:30 Introduction
Takatsugu Ochi
Member
IASB

09:35 IFRS Revenue Recognition
Henry Rees
Associate Director
IASB

10:15 Advisor’s perspective
Tony de Bell
Partner
PwC Global ACS

10:45 How we are preparing to implement forthcoming IFRS on Revenue Recognition
Christoph Hütten
Senior Vice President & Chief Accounting Officer
Head of Corporate Financial Reporting
SAP AG

11:15 Round-table Q&A
Chair:
Takatsugu Ochi
Member
IASB

Panellists:
• Henry Rees
• Tony de Bell
• Christoph Hütten

11:55 Concluding comments
Takatsugu Ochi
Member
IASB

12:00 Close session

Implementing
IFRS 10 Consolidated Financial Statements and IFRS 12 Disclosure of Interests in Other Entities

To assist you to prepare for the implementation of IFRS 10 Consolidated Financial Statements and IFRS 12 Disclosure of Interests in Other Entities, the IFRS Foundation will hold an intensive half-day session immediately before the IFRS conference, on the morning of 27 June 2013.

09:00 Registration and refreshments

09:30 Introduction
Philippe Danjou
Member
IASB

09:35 IFRS 10 Consolidated Financial Statements and IFRS 12 Disclosure of Interests in Other Entities
Alan Teixeira
Senior Director, Technical Activities
IASB

10:15 Investment entities
Sandra Thompson
Partner
PwC

10:45 How we implemented IFRS 10 and 12
David Bradbery
Managing Director, EMEA Head, Technical Accounting Group, Finance
Barclays

11:15 Round-table Q&A
Chair:
Philippe Danjou
Member
IASB

Panellists:
• Alan Teixeira
• Sandra Thompson
• David Bradbery

11:55 Concluding comments
Philippe Danjou
Member
IASB

12:00 Close session
The future of financial reporting

HANS HOOGERVORST
Chairman
IASB
International Financial Reporting Standards

Breaking the boilerplate
10 steps to encourage behavioural change in financial reporting disclosures

June 2013

Hans Hoogervorst
Chairman of the IASB

Topics

1. Progress towards global accounting standards

2. Current work programme

3. Financial reporting disclosures
1. Progress towards global accounting standards

First batch: Commitment to IFRSs as global standards

Public commitment in support of global accounting standards

IFRSs as those standards

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First batch: Adoption of IFRSs

Completion of IFRS adoption

- Completed adoption
- Not adopted or in process

European Union: IAS 39 'temporary carve-out'
99.5%+ of all EU companies report using full IFRS

Effective dates: A few jurisdictions deferred dates of several standards, notably IFRSs 9, 10, 11, 12

Pending completion of IASB projects: A few modifications pending completion of IASB projects
Remaining challenges

- Support the transition of remaining major economies
- Further enhance even application of standards

International Financial Reporting Standards

2. Current work plan
Impairment

- Replacing the ‘incurred loss’ impairment model with ‘expected loss’ approach

- Revised proposals published in March 2013
  - More timely recognition of credit losses
  - More faithful reflection of economics

- IASB and FASB to consider feedback on respective models

Insurance

- No proper IFRS standard for insurance accounting

- Much diversity and complexity in reported numbers

- Out-dated assumptions used to measure liabilities

- Balancing benefits against complexity
Conceptual framework

- Measurement - what method to use in which circumstances

- OCI - Profit or Loss as the primary performance indicator

International Financial Reporting Standards

3. Breaking the boilerplate
Short-term

1. Non-material information within the notes should be limited

2. Materiality applies to the whole of the financial statements, including the notes

3. Disclosures should be judged individually for materiality

4. Remove prescriptive ordering of disclosures

Short-term (cont.)

5. Important accounting policies to be given greater prominence

6. Consider adding a net-debt reconciliation requirement

7. Create education resources on materiality

8. Use less prescriptive wordings for disclosure requirements when developing new Standards
Medium term

9. Research project to undertake fundamental review of IAS 1, IAS 7 and IAS 8

10. Once completed, a general review of disclosure requirements in existing Standards

Thank you
IASB update

STEPHEN COOPER
Member
IASB

PHILIPPE DANJOU
Member
IASB

WAYNE UPTON
Chairman
IFRS Interpretations Committee
and Director of International Activities
IASB

ALAN TEIXEIRA
Senior Director, Technical Activities
IASB

SUE LLOYD
Senior Director, Technical Activities
IASB
IFRS technical update

• The new IASB work plan
• Recently issued IFRSs
• Major standards and projects
  – Financial Instruments
  – IASB-FASB MoU projects
  – Other projects
• Implementation
  – Interpretations
  – Narrow scope amendments
  – Post-implementation Reviews
• Research
The new IASB work plan

IASB agenda consultation

• The new work plan has been shaped by the Agenda Consultation
• Public review of the IASB’s technical programme every three years
• Helps the IASB establish a broad strategic direction for its work plan:
  – Establish a balance between:
    – improvements (new IFRSs); and
    – maintenance (implementation)
  – Determine whether to return to projects that have been deferred
  – Identify areas where improvements are needed
Consultation

• 2010-2011
  – IASB discussions begin with the IFRS Advisory Council

• July 2011
  – Request for Views published

• July – November
  – Extensive and focused consultation with investors – interviews and
    surveys. Public forums.

• November 2011
  – Comment deadline – 246 comment letters received

• December 2011 – January 2012
  – Four public round table discussions

Consultation

• January 2012
  – Comment summary presented to IASB

• February 2012
  – Feedback discussed with the Advisory Council

• May 2012
  – The Board considers a summary of the feedback received and a
    draft strategy and initial identification of project priorities.

• December 2012
  – The IASB published Feedback Statement, including a statement of
    priorities for the coming three years.

• Next consultation scheduled in 2015
Feedback

• Common views
  – Complete the four current projects (ie Revenue, Leases, Financial Instruments and Insurance Contracts)
  – Focus on maintenance over development of IFRSs in the near future
  – Utilise research from national-standard setters and academics
  – Complete the Conceptual Framework

Technical Programme

• Major projects
  – Research programme
  – Standards-level programme
• Conceptual Framework
• Implementation and Maintenance
  – Interpretations
  – Narrow-scope improvements
  – Post-implementation Reviews
Recently issued IFRSs

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

April 2013 Project update and the future work plan.

## Recently issued IFRSs - Suite of ‘consolidation’ standards

<table>
<thead>
<tr>
<th>IFRS</th>
<th>Effective Date</th>
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<tbody>
<tr>
<td>IFRS 10</td>
<td>Consolidated Financial Statements</td>
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<tr>
<td>IFRS 11</td>
<td>Joint Arrangements</td>
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<tr>
<td>IFRS 12</td>
<td>Disclosures of Interests in Other Entities</td>
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<tr>
<td>Amendments IFRS 10, 11, 12</td>
<td>Transition Relief</td>
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<tr>
<td>Amendments IFRS 10, IFRS 12, IAS 27</td>
<td>Investment Entities</td>
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<tr>
<td>IAS 27</td>
<td>Separate Financial Statements</td>
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<tr>
<td>IAS 28</td>
<td>Investments in Associates and Joint Ventures</td>
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</table>
### Recent IFRSs - Other

<table>
<thead>
<tr>
<th>IFRS</th>
<th>Effective Date</th>
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<tbody>
<tr>
<td>Amendments to IFRS 1</td>
<td>Government Loans</td>
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<tr>
<td>IFRS 7</td>
<td>New offsetting disclosures</td>
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<tr>
<td>IFRS 13</td>
<td>Fair Value Measurement</td>
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<td>IAS 19</td>
<td>Post-employment benefits</td>
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<tr>
<td>IFRIC 20</td>
<td>Stripping Costs in the Production Phase of a Surface Mine</td>
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<td>IAS 32</td>
<td>Clarified offsetting amendments</td>
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<tr>
<td>Amendments to IAS 36</td>
<td>Recoverable Amount Disclosures for Non-Financial Assets</td>
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<tr>
<td>IFRIC 21</td>
<td>Levies</td>
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<tr>
<td>IFRS 9</td>
<td>Financial Instruments</td>
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## IASB Work plan – as at 30 May 2013

### Major IFRSs

<table>
<thead>
<tr>
<th>Major IFRSs</th>
<th>Next major project milestone</th>
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<tr>
<td>IFRS 9: Financial Instruments (replacement of IAS 39)</td>
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<tr>
<td>Classification and Measurement (Limited amendments)</td>
<td>Redeliberations</td>
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<tr>
<td>Impairment (comment period ends 6 July 2013)</td>
<td>Redeliberations</td>
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<tr>
<td>Hedge Accounting</td>
<td>Target IFRS</td>
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<tr>
<td>Accounting for Macro Hedging</td>
<td>Target DP</td>
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<tr>
<td>Insurance Contracts</td>
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<tr>
<td>Leases (comment period ends 13 September 2013)</td>
<td>Redeliberations</td>
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<tr>
<td>Rate-regulated Activities</td>
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<td>Interim IFRS (comment period ends 4 September 2013)</td>
<td>Redeliberations</td>
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<tr>
<td>Rate Regulation</td>
<td>Target DP</td>
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<tr>
<td>Revenue Recognition</td>
<td>Target IFRS</td>
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</table>

IFRS for SMEs: Comprehensive Review 2012-2014 – see project page

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Classification and measurement

- Objective – limited amendments to IFRS 9
- Proposed
  - clarification of hold to collect business model
  - introduction of FVOCI category for simple debt instruments
  - clarification of principal and interest criteria
  - ‘own credit’ changes can be early applied in isolation
- Joint project with FASB
- Timing
  - exposure draft published November 2012
  - comment period ended
  - summary of feedback provided May and June meetings
  - joint redeliberations commence July 2013

Impairment of financial instruments

- Objective to improve:
  - timeliness of recognition of expected credit losses
  - information about credit quality
- Exposure draft published in March 2013 proposes:
  - single impairment model
  - expected credit losses always recognised
  - full lifetime expected credit losses recognised when credit quality deteriorates significantly
- Timing
  - comment period ends 5 July 2013
  - overlap with FASB ED
  - FASB and IASB will consider opportunities to further align based on feedback at in person meeting in July 2013
Accounting for hedges

- Hedge accounting (general model)
  - more closely aligned to risk management
  - Review Draft published September 2012
  - final discussion of comments from Review Draft April 2013
  - election to use IAS 39 or IFRS 9 hedge accounting model
  - final IFRS mid 2013

- Accounting for macro hedges
  - risk management practices for open portfolios not covered by 2010 ED
  - Discussion Paper before ED
  - planned for 2013

International Financial Reporting Standards

Other MoU projects
Revenue recognition

- Objective – to develop a single, principle-based revenue standard for IFRSs and US GAAP
- Completed substantive redeliberations of revised Exposure Draft (published November 2011)
- At May 2013 meeting IASB gave permission to ballot
- Expected publication of IFRS Q3 2013
- Effective date 1 January 2017 with early application permitted

Leases

- The FASB and IASB have developed a common model
- Lessee accounting:
  - All leases of more than 12 months are on-balance sheet
  - Most equipment leases: recognise amortisation and interest expense separately
  - Most property leases: recognise a single lease expense on a straight-line basis
- Lessor accounting:
  - Most equipment leases: recognise lease receivable and residual asset
  - Most property leases: continue to recognise the property being leased
- Issued revised Exposure Draft May 2013
Insurance contracts

- IFRSs today has no comprehensive standard for insurance contracts – creates diversity of accounting practices
- Objective – to increase comparability and transparency
- Joint project with FASB
  - Proposals aligned on the core approach, but differed conclusion on some important details
  - IASB and FASB due process steps not aligned (IASB has issued an Exposure Draft, FASB has not)
- IASB will issue revised Exposure Draft with targeted issues late June 2013
  - Builds on the 2007 Draft Paper and 2010 Exposure Draft
Rate regulated activities

- IFRS today has no comprehensive standard for rate-regulated activities
- Interim
  - Permit grandfathering of current accounting practices for recognition, measurement and impairment
  - Enhanced presentation and disclosure matters
  - Issued Exposure Draft April 2013
- Major project
  - Will consider whether rate regulation creates asset and liabilities and measurement of such assets and liabilities
  - Request for Information (issued end of March 2013)
  - Discussion Paper (Q4 2013)

IFRS for SMEs: Comprehensive Review 2012-2014

- IFRS for SMEs published July 2009
- Mid-2012 IASB issued Request for Information
- Responses
  - Discussed by SME Implementation Group (SMEIG) February 2013
  - SMEIG recommendations discussed by IASB in March 2013
- Issue Exposure Draft Q3 2013
- Micro-sized entities
  - Publish guidance in Q2 2013
## Conceptual Framework

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

### IASB Work plan – as at 30 May 2013

<table>
<thead>
<tr>
<th>Conceptual Framework (chapters addressing elements of financial statements, measurement, reporting entity and presentation and disclosure)</th>
<th>2013 Q1</th>
<th>2013 Q2</th>
<th>2013 Q3</th>
<th>2013 Q4</th>
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<td>Target DP</td>
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**Disclosures: Discussion Forum**

[Feedback Statement published 28 May 2013]
Conceptual Framework

- IASB project
  - Continues on work previously done before 2010
- Project restarted in September 2012 after feedback from the IASB agenda consultation in 2011
- Will address:
  - Elements of financial statements (ie assets, liabilities, equity, income, expenses)
  - The reporting entity
  - Measurement of the elements
  - Presentation (includes OCI)
  - Disclosure (includes interim reporting)
- Issue Discussion Paper in July 2013

Disclosure

- Disclosure forum held in January 2013
- Survey
- Feedback statement (issued May 2013)
- Next steps
  - Consider limited amendments to IAS 1
  - Materiality
  - Broader standards-level review of disclosures
    - Financial Statement Presentation
    - Other Standards
## Implementation

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

April 2013 Project update and the future work plan.

### IASB Work plan – as at 30 May 2013

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<thead>
<tr>
<th>Narrow-scope amendments</th>
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<tbody>
<tr>
<td></td>
<td>2013 Q1</td>
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<tr>
<td>Acquisition of an Interest in a Joint Operation (proposed amendments to IFRS 11)</td>
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<tr>
<td>Actuarial Assumptions: Discount Rate (proposed amendments to IAS 19)</td>
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<td>Annual Improvements 2010-2012</td>
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<tr>
<td>Bearer Plants (proposed amendments to IAS 41)</td>
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<tr>
<td>Clarification of Acceptable Methods of Depreciation and Amortisation (proposed amendments to IAS 16 and IAS 36)</td>
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<tr>
<td>Defined Benefit Plans: Employee Contributions (proposed amendments to IAS 19) (comment period ends 25 July 2013)</td>
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### Implementation (cont.)

<table>
<thead>
<tr>
<th>Narrow-scope amendments</th>
<th>2013 Q1</th>
<th>2013 Q2</th>
<th>2013 Q3</th>
<th>2013 Q4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disclosure Requirements about Assessment of Going Concern</td>
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<td>Target ED</td>
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<tr>
<td>(proposed amendments to IAS 1)</td>
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<td>Equity Method: Share of Other Net Asset Changes</td>
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<td>(proposed amendments to IAS 28)</td>
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<td>Fair Value Measurement: Unit of Account</td>
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<td>Target ED</td>
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<td>Novation of Derivatives and Continuation of Hedge Accounting</td>
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<td>(proposed amendments to IAS 39 and IFRS 9)</td>
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<td>Put Options Written on Non-controlling Interests</td>
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<td>(proposed amendments to IAS 30)</td>
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<td>Recognition of Deferred Tax Assets for Unrealised Losses</td>
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<td>(proposed amendments to IAS 12)</td>
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<td>Sale or Contribution of Assets between an Investor and its</td>
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<td>Target IFRS</td>
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<td>Associate or Joint Venture</td>
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<td>(proposed amendments to IFRS 10 and IAS 28)</td>
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<td>Separate Financial Statements (Equity Method)</td>
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<td>Target ED</td>
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<td>(proposed amendments to IAS 27)</td>
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### IFRS Interpretations Committee

- 2011 Review completed
- Four Messages
  - Partnership between the Board and the Committee
  - An expanded toolkit of responses
  - Agenda criteria to match the new direction
  - Rejection notices – Where to the stand in the hierarchy of IFRSs?
Bearer Plants

- Limited-scope amendment of IAS 41 Agriculture (and IAS 16 Property, Plant and Equipment)
- Proposes to include BBA in scope of IAS 16 Scope restricted to BBA that are plants (e.g., grape vines, oil palms)
- Issue Exposure Draft (24 June) 2013

Other

- Actuarial Assumptions: Discount rate
- Fair Value Measurement: Unit of Account / portfolios
- Put options Written on Non-controlling Interests
- Separate Financial Statements (Equity Method)
- Levies Charged by Public Authorities on Entities that Operate in a Specific Market – issued as IFRS 21 Levies in May 2013
- Novation of derivatives
Post-implementation Reviews

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

April 2013 Project update and the future work plan

IASB Work plan – as at 30 May 2013

<table>
<thead>
<tr>
<th>Next major project milestone</th>
<th>2013 Q1</th>
<th>2013 Q2</th>
<th>2013 Q3</th>
<th>2013 Q4</th>
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<tr>
<td>Post-implementation reviews</td>
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<tr>
<td>IFRS 8 Operating Segments</td>
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<tr>
<td>IFRS 3 Business Combinations</td>
<td></td>
<td>Publish report on post-implementation review</td>
<td>Initiate review</td>
<td></td>
</tr>
</tbody>
</table>
Post-implementation reviews

- The IASB now reviews each new IFRS or major amendment
- Scope
  - contentious issues identified during development of the standard or that have arisen since publication
  - unexpected costs or implementation problems encountered
- Timing of the review
  - Too early or too late?

Steps

- Phase A: develop the work plan
  - Reviewed the concerns that were expressed when the IFRS was developed
  - Consulted with standard-setters, auditors, users and others
- Phase B: investigate the issues
  - Request for information
  - Workshops with investors and non-investors
  - Additional sources
    - academic research
    - other outreach
- Phase C: reporting
  - our analysis of the issues and our responses to them
**IFRS 8 Operating Segments**

- **Scope**
- Initial findings discussed at January 2013 IASB meeting
- **Next steps**
  - Publish feedback statement Q3 2013

**IFRS 3 Business Combinations**

- **Scope**
  - All aspect of IFRS 3, in particular:
    - Definition of a business
    - Contingent consideration
    - Goodwill, including impairment
- **Timing**
  - Initial scoping meetings have begun.
  - Request for information planned for H2 2013
Research

Research programme

- A broad research and development programme
- Emphasis on defining the problem
  - Identify whether there is a financial reporting matter that justifies an effort by the IASB
  - Evidence based
- Discussion Papers
  - IASB staff papers
- Research Papers
  - Commissioned from others in the IFRS network
- Leads to project proposals, or recommendations not to develop an IFRS
Standards-level Programme

- Major projects feed from the research programme
- Narrower scope improvements feed from the interpretations committee and the other implementation outreach
- More focused and disciplined development of standards

Priority research projects

- Rate-regulated activities
- Emissions trading schemes
- Business combinations under common control
Priority research projects

- Discount rates
- The equity method of accounting
- Extractive activities | Intangible assets | Research and Development activities
- Financial Instruments with the Characteristics of Equity
- Foreign Currency Translation
- Liabilities – amendments to IAS 37
- Hyperinflation, and high inflation

The IFRS network

- ASAF
- Project level work
  - The IASB will work with other bodies in the IFRS community
  - Seconded to the IASB
  - Working independently, or in collaboration with other NSS
  - Successful past collaborations include:
    - Management Commentary
    - Extractive Activities
    - Intangibles
Keynote address

KLAAS KNOT  
President  
De Nederlandsche Bank (the Dutch Central Bank)
Technical update: financial instruments

HANS HOOGERVORST  
Chairman  
IASB

STEPHEN COOPER  
Member  
IASB

MARTIN EDELMANN  
Member  
IASB

SUE LLOYD  
Senior Director, Technical Activities  
IASB
Replacing IAS 39 – where are we?

- Classification & Measurement: IFRS 9 (2010) + ED of limited amendments
- Impairment: ED on Expected Credit Losses
- General Hedge accounting*: Review draft complete

* Macro hedge accounting is being deliberated separately from this project.

Mandatory effective date of IFRS 9 will be considered in redeliberations.
Limited Amendments

- IFRS 9 is fundamentally sound and operational
- Mindful of efforts to implement IFRS 9
- Three primary objectives:
  1. Improve interaction with accounting for insurance contracts
  2. Address narrow range of application questions
  3. Reduce key differences with FASB
**IFRS 9 as proposed**

- **Business model**
  - Amortised cost*
  - FVO for accounting mismatch

- **Contractual cash flow characteristics**
  - Fair Value (No impairment)
  - Equities: Fair Value OCI (available (alternative))

Reclassification required if business model changes

**All other instruments:**
- Equities
- Derivatives
- Some hybrid contracts
- ...

* Same impairment model

---

**Cash flow characteristics**

- Benchmark instrument cash flows
- Actual cash flows

**Compare**

Satisfies P&I test if effect of modification could not be more than insignificant
Transition – early application choices

Currently

- Classification & Measurement: Financial Assets
- OR
- All Classification & Measurement: Financial Assets + Financial
- OR
- All Classification & Measurement + General Hedge Accounting

Proposed

- Own Credit requirements
- OR
- All Classification & Measurement + Impairment + General Hedge Accounting

Feedback statistics

- 168 comment letters
- More than 60 outreach meetings
  - Including jointly with the FASB
- Online user survey – Over 40 responses from users
Clarifying solely P&I

- Nearly all welcomed the proposals and agreed ‘modified economic relationship’ can be solely P&I

BUT
- Questions about proposed application guidance
- Proposals do not go far enough
- Regulated rates
- Comments on topics outside the scope of the proposals

Proposed FVOCI category

- The majority of respondents supported FVOCI category
- Views broadly equally split between
  - Support FVOCI category as proposed
  - Support FVOCI with a variation
  - Do not support FVOCI
- Questions about clarity of distinction between business models
- Some questioned whether holding to sell or collect is really a business model
Clarifying ‘hold to collect’

• Many respondents agreed ‘hold to collect’ is clearer

BUT
  – Some disagreed with the outcome
  – Many challenged particular details of the proposals

• Questions on business model assessment
  – Most notably, the emphasis on selling activity
  – Treatment of sales to meet regulatory requirements and for credit risk concentration

Transition

• Nearly all supported early application of just ‘own credit’ requirements

BUT
  – Requested it to be available before IFRS 9 is completed e.g. by incorporating in IAS 39 or IFRS 9 (2010)

• Many asked the IASB to confirm the deferral of the mandatory effective date of IFRS 9 as soon as possible
  – Currently 1 January 2015
Other key themes

• Complexity
  – Many noted increased complexity
  – Some stated added complexity is justified, others stated it contradicts the original objective of reducing complexity

• Convergence
  – Many welcomed greater alignment with the FASB’s model
  – Some encouraged convergence in application guidance
  – Some emphasised changes should only be made if they improve IFRS
The basis for the proposals

- The yield on financial instruments reflects initial credit loss expectations
- When expected credit losses exceed those initially expected an economic loss is suffered
- This was best reflected in the 2009 ED
- Proposals reflect this in a more cost-effective way by:
  - Recognising a portion of expected credit losses initially
  - Recognising lifetime expected credit losses when significant deterioration in credit risk occurs

What does it apply to?

- Debt instruments measured at amortised cost
- Debt instruments mandatorily measured at fair value through other comprehensive income (FVOCI)
- Trade receivables and lease receivables
- Other financial instruments subject to credit risk, such as:
  - some loan commitments
  - some financial guarantee contracts

Expected credit losses will be recognised for all of these financial instruments at all times.
Overview of general model

Change in credit quality since initial recognition

Expected credit losses recognised

12-month expected credit losses

Lifetime expected credit losses

Lifetime expected credit losses

Interest revenue

Gross basis

Gross basis

Net basis

Stage 1
Performing

Stage 2
Underperforming

Stage 3
Non-performing

What are the three stages?

- Stage 1
  - No significant deterioration in credit quality; or
  - ‘Investment grade’

- Stage 2
  - Significant deterioration in credit quality; and
  - Not ‘investment grade’
  - Rebuttable presumption met if more than 30 days past due

- Stage 3
  - Credit-impaired or incurred loss has occurred

Expected credit losses are updated at each reporting date for new information irrespective of whether a financial instrument stays at the same ‘stage’
What are 12-month expected credit losses?

- Proxy for adjusting interest rate for initial expected credit losses
- Expected shortfall in all contractual cash flows given probability of default occurring in next 12 months
- **NOT:** Expected cash shortfalls in next 12 months
  - Credit losses on assets expected to default in next 12 months
- Example:
  - Portfolio of 10m loans
  - Probability of default in next 12 months is 2%
  - Entire loss that would arise on default is 10%
  - 12-month expected loss = 20,000 (2%×10%×10m)

Information used

- Information used to measure expected credit losses and assess changes in credit:
  - Available without undue cost or effort
  - Historical, current and reasonable and supportable forecasts
  - Historical information must be updated
  - Delinquency information may be used

  **Particular measurement methods are not prescribed; nor must PD be explicitly included as an input**

- Information that can be considered includes:
  - Borrower specific
  - Macro-economic
  - Internal default rates and probabilities of default
  - External pricing
  - Credit ratings
Expected credit losses

Need to estimate credit losses reflecting:

- Probability weighted outcome
  - Must consider (at least) possibility that a default will occur and that a default will not occur
- Time value of money
  - Reasonable rate between (and including) risk-free rate and effective interest rate

Estimation will be less difficult for 12-month expected credit losses because of the shorter time horizon

Assessment of deterioration in credit quality

Need to assess when significant deterioration has occurred:

- Change in probability of default occurring (not change in expected losses)
- Compared with initial recognition
- Maturity matters
- Operational simplifications:
  - Recognise 12-month expected credit losses if investment grade
  - Rebuttable presumption: significant deterioration when payments are more than 30 days past due
  - Don’t need to assess for trade and lease receivables
When to calculate net interest

- Interest is usually calculated on the gross carrying amount ie before the loss allowance
- Change to calculation on a net basis (ie on the amortised cost amount that is net of the loss allowance) when IAS 39 criteria for impairment are satisfied
- Consistent with population considered impaired under IAS 39 today (excluding IBNR)

Expected credit losses—example

As information emerges over time – entity is able to better distinguish credit quality of loans

- Portfolio of home loans originated in a country.
- Information emerges that a region in the country is experiencing tough economic conditions.
- More information emerges and the entity is able to identify the particular loans that are in default or will imminently default.

Stage 1
Stage 2
Stage 3
Exceptions to the general model

- **Simplified approach for trade and lease receivables**
  - Measure short-term trade receivables at lifetime expected losses
  - Policy election for long-term trade receivables and lease receivables

- **Assets credit-impaired on initial recognition**
  - Use credit-adjusted effective interest rate
  - Allowance balance represents changes in lifetime losses

Exceptions designed to achieve a better balance between the benefits and costs

---

Loan commitments and financial guarantee contracts

- **Apply general deterioration model**

- Instruments that create a present legal obligation to extend credit
- Longest period considered is contractual period exposed to credit risk
- Estimate usage behaviour
- Expected credit losses presented as liability on the balance sheet
Proposed disclosures

**Amounts**
- Reconciliation of gross carrying amounts and associated losses
- Reconciliation of allowance accounts
- Gross carrying amount per credit risk grades for financial assets and loan commitments
- Information on collateral held, modification

**Judgements**
- Inputs, assumptions and techniques used to estimate expected credit losses (and changes in techniques)
- Inputs, assumptions and techniques used to determine and ‘objective evidence of impairment’
- Inputs, assumptions and techniques used to determine ‘significant deterioration in credit risk’
- Write off policies

International Financial Reporting Standards

Hedge Accounting

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

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Timeline

December 2010
ED Hedge Accounting

March 2011
ED Comment letter deadline

September 2011
ED redeliberations completed

September 2012
Draft requirements posted on website for 90 days

January 2013
IASB discussed outstanding issues raised

April 2013
IASB finalises discussions of outstanding issues raised

Second half of 2013
Publication of final hedge accounting requirements

Major features of the new hedge accounting model

- Greater alignment with risk management including:
  - Eligibility criteria based on more economic assessment of hedging relationship
  - Expansion of risk components for non-financial items
  - Introduction of ‘costs of hedging’
  - Ability to hedge aggregated exposures (combination of derivative and non-derivative)
- Enhanced disclosures
- Will be added as a chapter to IFRS 9 (Chapter 6)
Discussions post review draft

• January 2013:
  – ‘Hypothetical derivatives’
  – Treatment of ‘proxy hedging’
  – Transition for ‘own use’ contracts

• April 2013:
  – Treatment of accounting for macro hedging on introduction of IFRS 9
  – Obtained permission to proceed to final document

Role of hypothetical derivatives

• Review draft confirmed that use of a ‘hypothetical derivative’ is a way to determine inputs for measuring hedge ineffectiveness
  – Used to measure changes in the value of the hedged item
  – Only an expedient—but not a method in its own right
  – Cannot include features not present in hedged item

• IASB confirmed that cross-currency basis spread is a cost of hedging, and desired to make this transparent

• Expanded notion of ‘costs of hedging’ for FX basis spreads
  – Incorporates cross-currency basis spread aspect for cash flow hedges and fair value hedges
Clarification of ‘proxy hedging’

Concern: whether ‘proxy hedging’ (use of designations that do not exactly represent risk management) is still possible under the new hedge accounting model given the emphasis on risk management

- Nature of accounting requirements inevitably results in many designations that constitute ‘proxy hedging’
- Use of ‘proxy hedging’ was confirmed
  - Designations must however be directionally consistent with risk management, which follows from:
    - The need to document the risk management objective and strategy
    - The disclosure requirements

Designation of ‘own use’ contracts as FVPL: Transition requirements

Concern: Review draft only allowed fair value option for ‘own use’ contracts to be made at initial recognition. Argued this phase-in reduced usefulness of information.

- Trade-off between:
  - **Point-in-time transition**: danger of ‘cherry-picking’
    - Can be mitigated by requiring election on ‘all-or-nothing’ basis
  - **Phased-in transition**
- Desire to avoid distortion of the accounting from ‘phasing-in’ outweighed concerns of ‘cherry-picking’

**Make FVPL election for all ‘own use’ contracts on ‘all-or-nothing’ basis for all similar contracts**
Grandfathering of IAS 39

- During January 2013 the IASB asked the staff to provide further analysis on 'macro cash flow hedge accounting' under IFRS 9
  - Outreach confirmed that clarifications from January meeting were supported and addressed the issues
  - IAS 39 compliant hedges should achieve hedge accounting under IFRS 9
  - Effect of migrating to IFRS 9 for 'macro cash flow hedges' should not be onerous
- However, the IASB decided that relief should be provided given the active project on accounting for macro hedging

'Status quo' pending completion of the project on accounting for macro hedging:
Novation of derivatives and continuation of hedge accounting

Why the need for an amendment?

- New regulation to mandate central clearing of over-the-counter (OTC) derivatives, prompted by a G20 commitment
- A novation of the hedging instrument to a central counterparty results in discontinuation of hedge accounting
- Concern about the financial reporting effect
- Published ED on urgent basis with a 30 day comment period

Amendments

- Introduce a narrow-scope exception to the requirement for the discontinuation of hedge accounting in IAS 39
- Allow hedge accounting to continue when novation of hedging instrument to central counterparty meets particular criteria
- Apply retrospectively for periods beginning on or after 1 January 2014 (with early application permitted)
- Similar relief will be included in IFRS 9
- Publication before 30 June
Accounting for macro hedging

Accounting for macro hedging so far

- Accounting for macro hedging is a separate project with the initial objective of preparing a Discussion Paper
  - Developing something very new => extra research and input needed
- Investigating a portfolio revaluation approach:
  - Exposures within a dynamically managed portfolio are revalued with respect to the managed risk
    - Offset arises in profit or loss
    - Carrying amount is (amortised) cost plus revaluation adjustment
  - Primary consideration is what is revalued and how it should be revalued
- Next step - Discussion Paper
  - Expected Q3 2013
Thank you
Technical break-out sessions:

Financial instruments: macro hedge accounting

MARTIN EDELMANN  
Member  
IASB

JANE HURWORTH  
Practice Fellow  
IASB
Interaction with hedge accounting

"Status quo" pending completion of the project on accounting for macro hedging:

- **IFRS 9 HA model**
  - 'macro CFH'
  - Early application
  - Accounting policy choice
  - No early application

- **IAS 39 HA model**
  - 'macro CFH'
  - Scope-out
  - 'macro FVH'
  - 'macro FVH'
Project scope

- Accounting for open portfolios or macro hedging

- Aim to develop an accounting solution so preparers can explain and users understand how businesses manage risk dynamically

- Considering an accounting solution for a variety of dynamic risk management activities. Not restricted to banks’ interest rate risk management, eg commodity and FX risk
Accounting for macro hedging: Portfolio revaluation approach overview

What is macro hedging?

- Where risk management is undertaken on a dynamic basis for open portfolios:
  - New exposures may be continuously added and existing exposures expire
  - Exposures considered in contemplation of one another - the net risk position is managed
  - Management is of risk from external exposures only
  - Given this, risk management is dynamic

- Another common factor is that calculation of risk managed exposures may include an element of estimation in terms of volume and/or timing.
Portfolio revaluation approach overview

• The portfolio revaluation approach itself is simple – complexity only arises when considering how and what should be revalued

• Exposures within the dynamically managed portfolio are revalued with respect to the managed risk
• No change to accounting for hedging instruments
• Offset arises in profit or loss, to the extent of offsetting risk positions
• Performance reflects transformed risk base
• No requirement for specific linkage of exposures and hedging instruments, consistent with risk management

Benefits of portfolio revaluation approach

• Transparent representation of risk management activities
  – Alignment between accounting and risk management view
  – Provides information on impact of risk management activity on reported results
  – Information on residual risk positions

• Reduction in cumbersome patchwork hedge accounting solutions in financial statements
  – Economic volatility is more accurately portrayed

• Operational relief from reduction in tracking and amortisations from frequent dedesignations and redesignations

• Greater opportunity to use data already used for risk management
### Mechanics of the portfolio revaluation approach

![Graph showing the mechanics of the portfolio revaluation approach.]

### Portfolio revaluation approach – balance sheet treatment

<table>
<thead>
<tr>
<th>DR/(CR)</th>
<th>Amortised cost</th>
<th>Revaluation adjustment</th>
<th>Fair value</th>
<th>Balance sheet presentation alternatives</th>
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<tr>
<td><strong>Assets</strong></td>
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<td>Line by line</td>
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<td>Macro hedging revaluation</td>
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<td>Derivatives</td>
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<td><strong>Liabilities</strong></td>
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<td>Deposits</td>
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<td>Firm commitments</td>
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<td>Macro hedging revaluation</td>
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<td>(29)</td>
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<td><strong>P&amp;L from risk management activities</strong></td>
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<td>4</td>
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</table>
Key aspects of the revaluation approach

- Treat portfolio as unit of account, including behaviourisation
  - Prepayable fixed rate loan portfolios
- Inclusion of exposures with ‘deemed’ interest rate risk
  - Equity model book
  - Core demand deposit replication portfolio
- Role of transfer pricing deals representing the transfer of risk to ALM for inclusion in dynamic risk management
  - Benchmark rates only
  - Risks actually managed by ALM
- Gross treatment in P&L for internal derivatives
- Portfolio revaluation adjustment is sum of revaluation adjustment for individual exposures in portfolio

Overview of portfolio revaluation approach for typical bank

- Fair value
- Hedging instruments
- Revaluation of portfolio by risk on behaviourised basis
- Revaluation of individual exposures by risk on contractual basis
- Prepayable mortgages
- Pipeline transactions
- Fixed rate non-prepayable instruments
- Floating rate instruments
- Firm commitments
- Core demand deposits
- Non-core demand deposits
- Equity Model Book
Alternatives included within DP

- **Scope**
  - Holistic application wherever dynamic risk management is undertaken (by risk)
  - Discrete sub-portfolio within dynamically managed portfolio
  - Mandatory v optional application

- **Income statement presentation**
  - Actual net interest rate approach
  - Stable net interest rate approach

- **Statement of financial position presentation**
  - Line by line gross up
  - Aggregate assets and liabilities
  - Net balance

More challenging risk management concepts also covered in DP

- **Risk limits**
  - As long as within the risk limit set by management, a hedge is regarded as perfectly or automatically effective

- **Bottom layer**
  - For prepayable portfolios, assume all prepayment risk occurs in top layer, until bottom layer is breached

- **Proportional approach**
  - Apply revaluation approach to hedged proportion of managed portfolio, eg 80%

- **Pipeline trades**
  - Deemed fair value interest rate risk from publicly offered financial instruments
What does dynamic risk management look like for banks?

- Risk management objective to transform net interest margin to have desired level of sensitivity to changes in market interest rates.
  - For some (not all) banks the objective will be to stabilise net interest margin
- Usually achieved by balancing interest bearing assets and liabilities so timing and basis of future interest rate fixings, combined with derivatives, mitigate residual interest rate mismatches to desired amount
- Central asset and liability management (ALM) function often performs dynamic risk management for all banking book exposures using sensitivity or similar calculations to calculate residual risk positions
What the model should apply to

- Which portfolios should the revaluation approach be applied to?
  - Include all dynamically managed portfolios (likely to mean whole banking book) or
  - Focused selection of discrete portfolios
- Optional or mandatory application
- Key discussion is whether accounting for macro hedging should reflect risk management in its entirety (holistic view) or only to the extent risk is actually hedged (minimisation of profit or loss volatility view)
- Core issue is the usefulness of the information provided

Scope alternatives

1. All banking book exposures
2. Dynamically managed banking book portfolios
3. Sub portfolios
   - Dynamically managed banking book portfolios
   - Sub portfolio
4. Dynamically managed banking book portfolios
   - Unmanaged or static risk management
   - Apply revaluation approach
   - Do not apply revaluation approach
Eligibility of managed exposures

<table>
<thead>
<tr>
<th>Exposures included within dynamic risk management</th>
<th>Eligible for inclusion within revalued portfolio</th>
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<tbody>
<tr>
<td>Recognised external assets and liabilities at amortised cost</td>
<td>Yes</td>
</tr>
<tr>
<td>External firm commitments - unrecognised contractual assets and liabilities</td>
<td>Yes</td>
</tr>
<tr>
<td>External pipeline transactions</td>
<td>Maybe</td>
</tr>
<tr>
<td>Internal exposures</td>
<td>No</td>
</tr>
<tr>
<td>Deemed interest rate risk in non financial assets and liabilities</td>
<td>Maybe, depends on underlying exposure</td>
</tr>
<tr>
<td>Forecast external transactions</td>
<td>No</td>
</tr>
<tr>
<td>Recognised external assets and liabilities at FVTPL</td>
<td>No, possibly eligible hedging instruments</td>
</tr>
</tbody>
</table>

Calculation of portfolio revaluation adjustment

- Portfolio revalued by **aggregating** the revaluation of all exposures in the portfolio for the managed risk.
- Individual exposures revalued by calculating **net present value** (NPV) of cashflows included within dynamic risk management with respect to prevailing market interest rates. For example:

On 1 Jan 20XX a 5 year £100m loan paying 5% interest semi annually is given to a corporate. The interest rate risk transferred to ALM for management is the 5 year semi annual market interest rate, equal to 3%. 

2% credit spread

3% market interest rate component included in dynamic risk management

3% market interest rate

coupon payable on the loan
Calculation of portfolio revaluation adjustment - Continued

<table>
<thead>
<tr>
<th>Date</th>
<th>Market interest rate *</th>
<th>NPV</th>
<th>Revaluation adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>30/6/20X3</td>
<td>3.0%</td>
<td>£100m</td>
<td>-</td>
</tr>
<tr>
<td>31/12/20X3</td>
<td>3.3%</td>
<td>£99m</td>
<td>£1m</td>
</tr>
<tr>
<td>31/12/20X3</td>
<td>3.6%</td>
<td>£98m</td>
<td>£2m</td>
</tr>
<tr>
<td>30/6/20X4</td>
<td>4.2%</td>
<td>£96m</td>
<td>£4m</td>
</tr>
</tbody>
</table>

DCF based on 4.2% annualised market rate

Actual net interest rate approach

* Present value of deposit is zero as it refixes to market on valuation day
Balance sheet presentation

- Balance sheet presentation alternatives include:
  - **Line by line balance sheet gross up** – exposures included within managed portfolio recognised at default carrying amount *plus* associated revaluation adjustments
  - **Separate lines for aggregate adjustments to assets and liabilities** – Single balance sheet line item for revaluation adjustment for managed assets, similar presentation for managed liabilities
  - **Single net balance sheet line item** – net revaluation adjustments for all managed exposure recorded in single balance sheet line item
  - Additional considerations required for unrecognised managed exposures
Portfolio as unit of account

- Where portfolios are managed on basis of behaviourised expected cash flows, treating the portfolio as unit of account best represents risk management in the financial statements.

- Considering a prepayable mortgage portfolio:
  - Each borrower has an option to prepay their individual mortgage any time, but a lender knows neither whether or when prepayment might occur for an individual mortgage.
  - However, at a portfolio level, the lender can estimate the expected amount and timing of prepayments, based on past experience.

- Calculation of revaluation adjustment based on up to date estimates for outstanding mortgages in portfolio:
  - Reflects dynamic approach without need for tracking and amortisations.
  - Where actual behaviour matches estimated behaviour no volatility if perfectly hedged.

Behaviourised portfolios

- Prepayable mortgage portfolio
Prepayment Risk in Demand Deposits

- At a portfolio level, the ‘sticky’ nature of demand deposits leads to existence of a stable portion in the amount outstanding.
- These core demand deposits are regarded as fixed rate deposits with longer maturities for risk management purposes.
- Strong homogeneous character as a portfolio, replacements in portfolio have same terms as other portfolio items in respect of maturity (on demand) and interest rates (zero or very low) and typically are insensitive to changes in market interest rates.

Core Demand Deposits - Simple Approach

<table>
<thead>
<tr>
<th>Period</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>receive fixed derivative</td>
<td>100</td>
<td>80</td>
<td>receive fixed derivative</td>
<td>100</td>
<td>80</td>
<td>receive fixed derivative</td>
<td>100</td>
<td>80</td>
<td>future deemed fixed rate deposits likely to fix at same interest rate</td>
<td></td>
</tr>
<tr>
<td>on maturity new derivative to hedge new deemed fixed rate position will refix to prevailing market interest rate</td>
<td>80</td>
<td>60</td>
<td>on deemed maturity, deposit will refix, but as insensitive to market interest rates is likely to remain unchanged</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>future derivative fixes at prevailing market rates</td>
<td>60</td>
<td>40</td>
<td>40</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>deemed 5 year pay fixed 0.1%</td>
<td>40</td>
<td>40</td>
<td>40</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.9% net interest margin locked in for entire 5 year period assumes all assets are floating rate</td>
<td>40</td>
<td>40</td>
<td>40</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>future net interest margin sensitive to market rates</td>
<td>40</td>
<td>40</td>
<td>40</td>
<td>40</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(20)</td>
<td>(40)</td>
<td>(60)</td>
<td>(80)</td>
<td>(100)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3.9% net interest margin locked in for entire 5 year period assumes all assets are floating rate
Future net interest margin sensitive to market rates (0.9% in above fact pattern) assumes all assets are floating rate
Core Demand Deposits:
Roll-over strategy / Replication Portfolio

- Risk management objective for the above portfolio could be to hedge the bottom layer of 60 or 60% of whole portfolio
- Difficulties of identifying and quantifying the revaluation adjustment if hedging a proportion or a bottom layer of non homogeneous portfolio
  - What if the proportion hedged changes. Eg to 70%
  - Which exposures make up bottom layer?
Role of internal transactions

<table>
<thead>
<tr>
<th>Accounting</th>
<th>Business Unit</th>
<th>ALM</th>
<th>Trading</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amortised</td>
<td>Fixed rate customer lending</td>
<td>Fixed rate internal lending</td>
<td></td>
</tr>
<tr>
<td>cost</td>
<td>Amortised cost</td>
<td>External floating rate funding</td>
<td></td>
</tr>
<tr>
<td>FVTPL</td>
<td>Fixed rate internal funding</td>
<td>Internal IRS</td>
<td></td>
</tr>
<tr>
<td>FVTPL</td>
<td></td>
<td></td>
<td>External IRS</td>
</tr>
</tbody>
</table>

Revaluation approach: Revaluation adjustment posted for exposures in managed portfolio

BU funding and interest rate risk from external lending is transferred to ALM

ALM hedging decision to transfer interest rate risk to Trading desk

Representation of managed risk

- Internal lending (transfer pricing) transactions to quantify the cashflows that represent the managed risk in the external customer exposures
- Internal transfer pricing deals are not the managed exposures
- If managing net interest margin the managed risk would be the market funding index
- Is the transfer pricing deal a good enough representation of the managed risk in the external exposure?
Trading position – with substantial externalisation

<table>
<thead>
<tr>
<th>ALM</th>
<th>Trading</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed rate assets</strong></td>
<td><strong>Variable rate liabilities</strong></td>
</tr>
<tr>
<td><strong>Fixed rate liabilities</strong></td>
<td>Hedge of fixed rate exposure with internal pay fixed IRS</td>
</tr>
<tr>
<td>Fixed rate liabilities</td>
<td>Fixed rate exposure from internal rec fixed IRS</td>
</tr>
</tbody>
</table>

Internal derivatives are eliminated on consolidation

Open trading position

Stable consolidated P&L to the extent that external derivatives offset the revaluation of the hedged portfolio

Thank you
Deemed interest rate risk in non financial instruments

- Some banks disaggregate their return on equity into a **base return** and a **residual return**
  - The base return is the return equity holders expect as compensation for providing investment
  - The residual return is anything above that
- In order to ensure that banks can deliver that base return to equity holders, they may model that return and include it in their risk management activities - often called an **Equity Model Book**
- How might this risk management strategy be accommodated within an accounting solution for macro hedging?
  - What are the implications if it is not?
Equity model book example – reduction in hedging activity

- **Fixed rate assets**
- Hedge of fixed rate exposure with pay fixed IRS
- **Variable rate liabilities**
- EMB → targeted fixed rate return

Equity model book example – increase in hedging activity

- **Variable rate assets**
- Hedge of fixed rate exposure with receive fixed IRS
- **Variable rate liabilities**
- EMB → targeted fixed rate return
Pipeline trades: conceptual basis?

- **Pipeline trades**: financial instruments that are publicly offered for a period of time at fixed rates. For example, fixed rate mortgage or deposit rates advertised in branches.
  - Transactions are only *anticipated*, similar to a forecast transaction.
  - Deemed to have fair value interest rate risk as bank would feel obliged to honour the offer due to commercial pressures.

- However, is there any conceptual basis for recognising revaluation of a pipeline trade as an asset or liability?

Risk limits

- The basic concept of incorporating risk limits into the revaluation approach is:  
  *As long as the amount of risk is within the risk limit set by management, a hedge is regarded as perfectly or automatically effective.*

- Such an approach presents a moral hazard:  
  *The wider the risk limits are, the less revaluation volatility is recorded in profit or loss.*

- Operational difficulties if risk limits are breached

- Usefulness of information
Impact of risk limits approach

- Intentionally unhedged positions
- Imperfections in hedging strategies
  - Hedging instrument selection
  - Actual behaviour ≠ expected behaviour
- Fair valuation inputs for hedging instruments
Technical break-out sessions:

Leases

PHILIPPE DANJOU
Member
IASB

PATRINA BUCHANAN
Technical Principal
IASB

SARAH GEISMAN
Technical Manager
IASB
This presentation has been prepared to help stakeholders understand the current status of the leases project of the IASB and the FASB. The views expressed in this presentation are those of the presenters. Official positions of the IASB and the FASB are reached only after extensive due process and deliberations.

Agenda

- Background
- Overview
- Lessee accounting
- Lessor accounting
- Identifying a lease
- Other aspects
Background

Why a Leases project?

Lessee
- Most assets and liabilities are off-balance-sheet
- Limited information about operating leases

Lessor
- Lack of transparency about residual values
- Consistency with lessee proposals and revenue proposals

$1.25 trillion of off-balance-sheet operating lease commitments for SEC registrants*

* Estimate according to the 2005 SEC report on off-balance-sheet activities
The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

### How the proposals are an Improvement

<table>
<thead>
<tr>
<th>Existing accounting issues</th>
<th>Proposals</th>
<th>How the proposals are an improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lessee</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Most assets and liabilities are off-balance-sheet</td>
<td>Recognition of lease assets and liabilities for all leases of more than 12 months</td>
<td>Greater transparency about leverage, assets used in operations, and cash flows</td>
</tr>
<tr>
<td>Lessee</td>
<td>Enhanced disclosure requirements</td>
<td></td>
</tr>
<tr>
<td>Insufficient disclosure about operating leases</td>
<td>Separately account for residual asset Enhanced disclosures about residual asset's exposure to risk</td>
<td>Greater transparency about residual values</td>
</tr>
<tr>
<td>Lessor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of transparency about residual values of equipment and vehicles</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

International Financial Reporting Standards

Overview
Proposed right-of-use model

A lease contract conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

Lessor

Right-of-use asset

Lessee

Lease payments

Definition of an asset:
A resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Definition of a liability:
A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Control over right-of-use asset
- Physical possession of (access to) leased asset
- Lessor cannot retrieve leased asset

Unconditional obligation to pay
- Lessee cannot return leased asset (terminate lease) and avoid paying without breaching contract
Dual approach

Lease classification test
Lessee accounting

Initial measurement

Right of use asset (at cost) = Lease liability (present value of lease payments)
Payments included in the lease liability

Fixed payments
• non-cancellable period

Residual value guarantees
• expected amount

Measurement simplifications

Short-term leases
• Option to exclude leases of less than 12 months

Variable lease payments
• Excluded if linked to sales or use
• Included only if payments linked to index or rate

Options
• Excluded unless significant economic incentive to exercise option
Lessee accounting overview

<table>
<thead>
<tr>
<th></th>
<th>Balance sheet</th>
<th>Income statement</th>
<th>Cash flow statement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type A</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Most leases of</td>
<td>Right-of-use</td>
<td>Amortisation</td>
<td>Principal</td>
</tr>
<tr>
<td>equipment/vehicles</td>
<td>asset</td>
<td>expense expense</td>
<td>Interest</td>
</tr>
<tr>
<td></td>
<td>Lease liability</td>
<td>Interest expense</td>
<td></td>
</tr>
<tr>
<td><strong>Type B</strong></td>
<td></td>
<td>Single lease</td>
<td></td>
</tr>
<tr>
<td>Most leases of</td>
<td>Right-of-use</td>
<td>expense on a</td>
<td></td>
</tr>
<tr>
<td>real estate</td>
<td>asset</td>
<td>straight-line</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Lease liability</td>
<td>basis</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Single lease</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>payments</td>
<td></td>
</tr>
</tbody>
</table>

**Lessee accounting—Example**

<table>
<thead>
<tr>
<th></th>
<th><strong>Type A</strong></th>
<th></th>
<th><strong>Type B</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance sheet (year)</strong></td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>ROU asset</td>
<td>600</td>
<td>400</td>
<td>200</td>
<td>-</td>
</tr>
<tr>
<td>Lease liability</td>
<td>(600)</td>
<td>(414)</td>
<td>(215)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Income statement (year)</strong></td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>200</td>
<td>200</td>
<td>200</td>
<td>-</td>
</tr>
<tr>
<td>Finance expenses</td>
<td>45</td>
<td>32</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td><strong>Total lease expense</strong></td>
<td>245</td>
<td>232</td>
<td>216</td>
<td></td>
</tr>
</tbody>
</table>
Lessee disclosures

Qualitative
- General description of leases
- Terms of:
  - variable lease payments
  - extension/termination options
  - residual value guarantees*
- Restrictions and covenants
- Information about leases not yet commenced

Quantitative
- Maturity analysis of undiscounted cash flows for each of first 5 years plus total thereafter
- Reconciliation of lease liability*
- Expense relating to variable lease payments
- Reconciliation of right-of-use asset by asset class*

Judgements & Risks
- Nature and extent of risks arising from leases
- Significant assumptions and judgement

* New disclosure compared to today for operating leases

International Financial Reporting Standards

Lessee accounting

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Lessor accounting model

Most equipment/vehicle leases
- Lease receivable
- Residual asset
- Interest income and any profit on the lease*

Most property leases
- Continue to report asset being leased
- Rental income

* Portion of overall profit on equipment/vehicle that relates to lease recognised when asset made available to lessee.
Portion of profit that relates to residual recognised only when equipment/vehicle sold or released at end of lease.

Example Type A lease

<table>
<thead>
<tr>
<th>Balance sheet (year)</th>
<th>0</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lease receivable</td>
<td>600</td>
<td>414</td>
<td>215</td>
<td>-</td>
</tr>
<tr>
<td>Gross residual asset</td>
<td>400</td>
<td>431</td>
<td>464</td>
<td>500</td>
</tr>
<tr>
<td>Unearned profit</td>
<td>(20)</td>
<td>(20)</td>
<td>(20)</td>
<td>(20)</td>
</tr>
<tr>
<td>Net residual asset</td>
<td>380</td>
<td>411</td>
<td>444</td>
<td>480</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income statement (year)</th>
<th>0</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit on lease</td>
<td>30</td>
<td>45</td>
<td>32</td>
<td>16</td>
</tr>
<tr>
<td>Interest on receivable</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest on residual asset</td>
<td>31</td>
<td>33</td>
<td>36</td>
<td></td>
</tr>
<tr>
<td>Total lease income</td>
<td>30</td>
<td>76</td>
<td>65</td>
<td>52</td>
</tr>
</tbody>
</table>
Disclosures lessor

Qualitative
- General description of leases
- Terms of:
  - variable lease payments
  - extension/termination options
  - purchase options

Quantitative
- Reconciliation: lease receivable and residual asset\(^1\)
- Table of lease income\(^2\)
- Maturity analysis undiscounted cash flows for each of first 5 years plus total thereafter
- Risk management for residual assets\(^1,2\)

Judgements & Risks
- Nature and extent of risks arising from leases
- Significant assumptions and judgement\(^2\)

---

1 For Type A leases only
2 New disclosure compared to today for operating leases

International Financial Reporting Standards

Identifying a lease

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Scope of leases proposals

Leases

- Identified asset
- Explicitly or implicitly specified
- No substantive substitution right
- Decision-making authority
- Right to receive substantially all benefits
- Right to control the use

Multi-element contracts

Contract contains a lease

<table>
<thead>
<tr>
<th>Separation</th>
<th>Allocation (lessee)*</th>
</tr>
</thead>
</table>
| • Each lease component is accounted for as a separate lease | • Allocation between lease and non-lease components based on stand-alone prices  
• If stand-alone prices not available, lessee combines components and accounts for them as a single lease |

* Lessor: allocate using revenue recognition guidance
International Financial Reporting Standards

Other aspects

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Sale and leaseback

Sale and leaseback?
Use revenue recognition requirements to determine whether control of the asset has transferred to buyer

<table>
<thead>
<tr>
<th>yes</th>
<th>no</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounted for as sale and leaseback</td>
<td></td>
</tr>
<tr>
<td>• Seller accounts for sale and applies lessee accounting</td>
<td></td>
</tr>
<tr>
<td>• <strong>Full gain recognised on day 1</strong></td>
<td></td>
</tr>
<tr>
<td>• Buyer accounts for purchase and applies lessor accounting</td>
<td></td>
</tr>
<tr>
<td>• Transaction adjusted for current market rates</td>
<td></td>
</tr>
<tr>
<td>• <strong>Specific real estate guidance in US GAAP eliminated</strong></td>
<td></td>
</tr>
</tbody>
</table>

| Accounted for as a financing arrangement |
| • Seller continues to recognize the transferred asset and accounts for amounts received as financial liability |
| • Buyer accounts for amounts paid as receivable |
Transition

Modified retrospective approach*

- Simplifications
  Modified approach based on information available at beginning of earliest comparative period

- Reliefs available
  - Use of hindsight
  - No evaluation of initial direct costs for contracts before effective date
  - Lessee: use 'portfolio level' discount rate calculated at effective date

- Carryover finance lease
  No requirement to make adjustments for leases currently classified as finance leases

* Entity can choose to apply the new Leases standard retrospectively

Next Steps

- Comment period ends September 13, 2013
- Issued Exposure Draft May 2013
- New Standard Effective TBD
- New Standard Issued TBD
- Joint Redeliberations Q413
Thank you
Technical break-out sessions:

Rate regulated activities

STEPHEN COOPER

Member
IASB

JANE PIKE

Senior Technical Manager
IASB
Agenda

- Background
- The previous IASB Rate-regulated Activities project
- The new IASB Rate-regulated Activities project
  - Overview
  - Interim proposals - ED *Regulatory Deferral Accounts*
  - Main project – Discussion Paper
    - Request for Information: *Rate Regulation*
- Next steps
- Q&A
Rate-regulated Activities - Background (1)

- Rate regulation is a restriction in the setting of prices that can be charged to customers for (usually essential) goods or services.
- Objectives of the rate regulator usually involve:
  - setting ‘just and reasonable rates’ for consumers;
  - ensuring the financial viability of suppliers; and
  - protecting the availability and stability of supply.
- Rate regulation usually requires suppliers to increase the selling price (rate) to recover ‘allowable’ costs, or lower the rate to eliminate ‘excess’ profits.
- Rate changes usually apply prospectively and are often designed to ‘smooth’ the impact of rate changes over time.

Rate-regulated Activities - Background (2)

Some national GAAPs permit or require regulatory balances to be recognised in financial statements – either as separate ‘regulatory assets’ or ‘regulatory liabilities’, or as part of another asset or liability balance (eg part of the cost of property, plant and equipment).

- **Regulatory debit balances** represent deferred ‘allowable’ costs (the rate regulation gives the entity the right to increase future rates).
- **Regulatory credit balances** generally represent deferred ‘excess’ profits (the rate regulation requires the entity to reduce future rates).

No specific guidance in IFRS.
Requests for guidance

Historically, calls came from Europe for guidance

- Desire to use US GAAP to recognise regulatory balances
- IFRS Interpretations Committee decided US guidance was not fully consistent with IFRS Conceptual Framework and other Standards
- Predominant practice = regulatory balances not recognised in IFRS financial statements

Later, more calls came for clear guidance and greater convergence with US GAAP

- Project added to IASB Agenda in Dec 2008
- Exposure Draft Rate-regulated Activities published in July 2009 (the 2009 ED)

Earlier Rate-regulated Activities project

- 2009 ED proposed that regulatory balances should be recognised as assets and liabilities for certain (cost-of-service) types of rate regulation
  - Responses split evenly between:
    - Support in principle for recognition (mainly those that already recognise, eg USA, Canada, Brazil and India) but disagreement with proposed present value measurement
    - Opposition in principle from others (on grounds that regulatory balances do not meet the IFRS definitions of assets/liabilities)

- IASB could not reach consensus on fundamental issues so suspended the project in September 2010

- Responses to 2011 Agenda Consultation recommended restarting the project to try to find a solution
The new Rate-regulated Activities project

IASB started renewed Rate-regulated Activities project in September 2012

2 distinct paths

Short-term interim solution (Exposure Draft (ED) Regulatory Deferral Accounts published in April 2013 – deadline for comment 4 September 2013)

Longer-term comprehensive project (starting with a research phase; target Discussion Paper (DP) in Q4 2013)

Interim solution: ED Regulatory Deferral Accounts

Interim solution proposes:

• to permit first-time adopters of IFRS to continue to recognise regulatory balances in accordance with their existing local GAAP (recognition and measurement)
• to require the impact of recognising regulatory balances to be isolated in order to allow direct comparison with rate-regulated entities that do not recognise regulatory balances (presentation and disclosure)
### How will the proposals affect IFRS financial statements (1)

<table>
<thead>
<tr>
<th>No impact on existing IFRS financial statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>No impact on cash flows</td>
</tr>
<tr>
<td>Isolated impact of recognising regulatory balances in the financial statements:</td>
</tr>
<tr>
<td>2 line items in the balance sheet:</td>
</tr>
<tr>
<td>• Regulatory debit balances – after total assets</td>
</tr>
<tr>
<td>• Regulatory credit balances – after total liabilities</td>
</tr>
<tr>
<td>1 line item in profit or loss – after profit before tax</td>
</tr>
</tbody>
</table>

- Isolation of regulatory balances should improve comparability:
  - should improve transparency of reported regulatory impact
  - regulatory amounts will no longer be incorporated within other line items in balance sheet or income statement
  - all other line items presented in accordance with IFRS

### How will the proposals affect IFRS financial statements (2)

- If finalised, the Standard will lower a significant barrier to the adoption of IFRS for many entities:
  - will allow users to compare a greater number of rate-regulated entities across a wider range of countries
  - limited scope (only first-time adopters that already recognise regulatory balances) will introduce some inconsistency in IFRS financial statements
More research is needed on the nature of different types of rate regulation

- Request for Information-Rate Regulation (issued in March 2013 – deadline for responses 30 May 2013)

Responses will feed into the DP:
- What information about the effects of rate regulation are most useful to users
- Does rate regulation create assets/liabilities (link to restarted Conceptual Framework project)

**Rfl - Rate Regulation**

- Fact-finding document
  - What are the main objectives of rate regulation?
  - How does the rate-setting mechanism reflect these objectives?
  - What rights and obligations are created?
  - How are rights enforced and obligations settled?

- >70 responses, providing information from >25 countries and 8 broad industry types*

*responses received by 11 June 2013
Objectives of rate regulation

<table>
<thead>
<tr>
<th>Substitute for competition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Main objectives</strong></td>
</tr>
<tr>
<td>• ‘just and reasonable rates’</td>
</tr>
<tr>
<td>• low prices for consumers</td>
</tr>
<tr>
<td>• reasonable rate of return for suppliers/investors</td>
</tr>
<tr>
<td>• reducing price volatility for consumers</td>
</tr>
</tbody>
</table>

Price-setting mechanisms

- Cost-plus
- Revenue / price-cap
- Incentive-based
- Competition
What we need to know from interested parties

We will need input from interested parties at various stages, including:

- reaction to the interim solution ED
- will it achieve greater comparability and transparency?
- will the information to be presented and disclosed be understandable and useful?
- input to the research for the DP
- what are the common features of rate regulation?
- reaction to the DP
- what information about the effects of rate regulation is most useful?

Rate-regulated activities project timeline

- July 2009: IASB published Exposure Draft of Rate-regulated Activities proposals
- September 2010: IASB suspended project
- March 2013: IASB published Request for Information - Rate Regulation (research project)
- April 2013: IASB published Exposure Draft of Regulatory Deferral Accounts (interim ED)
- Q4 2013: IASB expects to publish Discussion Paper for Rate-regulated Activities (research project)
- Q1 2014: IASB expects to finalise interim IFRS on Regulatory Deferral Accounts
Where to go for more information

- Rate-regulated Activities project page on the IFRS website

Jane Pike jpike@ifrs.org
Senior Technical Manager, IASB

Thank you
Technical break-out sessions:

Conceptual Framework (Part 1):
presentation and disclosure (including XBRL)

TAKATSUGU OCHI  
Member  
IASB

PETER CLARK  
Director of Research  
IASB

KRISTY ROBINSON  
Technical Principal  
IASB
Session overview

• Why?
• Where are we?
  – Timetable
• Focus on:
  – Presentation
  – Disclosure
  – XBRL
• Questions
Why?

- Previous joint project with FASB suspended in 2010
- Agenda consultation
  - Priority project
- Purpose of Conceptual Framework project
  - Not a fundamental rethink
  - Update, improve and fill in gaps
  - Focus on problems in standard-setting

Where are we?

- Objective of financial reporting
- Qualitative characteristics

ED
- Reporting entity

Completed

Now
- Everything else on financial statements
**Objective of financial reporting**

To provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. (OB 2)

Information about resources and claims against the entity, and changes to them

Information to assess effective and efficient management of resources

---

**Qualitative characteristics**

Fundamental qualitative characteristics

Useful

Enhancing qualitative characteristics
Fundamental QCs

Relevance

Faithful representation

Useful

Enhancing QCs

Useful

Comparability

Understandability

Verifiability

Timeliness
Timetable

Jul 2013
Issue DP
6-month
comment period

Q4 2014
Issue ED

End 2015
Final

International Financial Reporting Standards

Presentation and
disclosure

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.
Presentation vs disclosure

• Presentation = disclosure of information on the face of the primary financial statements
• Disclosure = process of providing useful information about the reporting entity to users

Current problems

Not currently addressed

Presentation
How to present performance?

Disclosures
May lead to poorly targeted disclosure requirements

Profit or loss

Other comprehensive income (OCI)
Problems: OCI now

<table>
<thead>
<tr>
<th>Recognised asset or liability</th>
<th>Remeasurement gains or losses in OCI</th>
<th>Recycle?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets measured at fair value through OCI [IFRS 9 ED]</td>
<td>Changes in discount rate</td>
<td>Yes</td>
</tr>
<tr>
<td>Insurance contracts [ED]</td>
<td>Changes in discount rate</td>
<td>Yes</td>
</tr>
<tr>
<td>Financial liabilities designated at fair value through profit/loss</td>
<td>Changes in fair value due to issuer’s own credit risk</td>
<td>No</td>
</tr>
<tr>
<td>Property, plant &amp; equipment, intangible assets, exploration &amp; evaluation assets</td>
<td>Revaluation gain or reversals</td>
<td>No</td>
</tr>
<tr>
<td>Net investment in foreign operations (and hedges)</td>
<td>Exchange differences</td>
<td>Yes</td>
</tr>
<tr>
<td>Pensions – net defined benefit assets or liabilities</td>
<td>Remeasurement</td>
<td>No</td>
</tr>
<tr>
<td>Designated investments in equity instruments</td>
<td>Change in fair value</td>
<td>No</td>
</tr>
<tr>
<td>Cash-flow hedging instruments</td>
<td>Effective portion of changes in fair value</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Presentation

Primary financial statements

- Primary financial statements:
  - Statement of financial position
  - Statement of profit or loss and other comprehensive income
  - Statement of changes in equity
  - Statement of cash flows
  - All statements are equally important
  - Summaries and not complete in themselves

Principles for presentation

- Classification and aggregation
- Offsetting
- Relationship between primary financial statements
Presentation of performance

What is performance?

- Statement of profit or loss and other comprehensive income
- Profit or loss – widely used
- Gross profit
- EBITDA
- Statement of financial position
- Changes in financial leverage
- Statement of cash flows

Statement of comprehensive income

Discussion paper approach

- All items of income and expense provide some information about financial performance
- Make best use of subtotals or totals so information is useful
- Present as one or two statements
Proposed Profit or loss and OCI in the Conceptual Framework

- Retain profit or loss as a subtotal or total
  - IASB’s preliminary view
  - Two approaches to retain profit or loss:
    - Narrow use of OCI
    - Broad use of OCI

- Alternative approach
  - No subtotal (ie profit or loss or OCI) defined in the Conceptual Framework
  - No recycling
  - Not well supported

Retain profit or loss as a subtotal or total

- Items in profit or loss communicate the primary picture of the return an entity has made on its resources
  - A common starting point for analysis
- What distinguishes profit or loss items from OCI items?
  - Describe OCI (profit or loss is the default)
  - Changes in some current measures (remeasurements)
  - Decision for IASB, not preparers
  - IASB would not have to use OCI for all items that qualify
- Recycling
  - all or some?
Narrow use of OCI

- OCI contains only some remeasurements in two categories:
  - ‘Bridging items’: arises where same asset/liability is represented in balance sheet and profit or loss using two different measurements (see next slides)
  - ‘Mismatched remeasurements’: arises when offsetting impact of linked transactions or other events is not yet recognised eg cash flow hedging and foreign exchange translation

- OCI always recycled
‘Bridging items’

Example (IFRS 9 ED):
If financial assets are measured at amortised cost in the statement of profit or loss and fair value in the statement of financial position.

<table>
<thead>
<tr>
<th>Statement of profit or loss</th>
<th>20XX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income</td>
<td>A</td>
</tr>
<tr>
<td>Impairment</td>
<td>(B)</td>
</tr>
<tr>
<td>Reclassification adjustment on disposal</td>
<td>C</td>
</tr>
<tr>
<td>Profit or loss</td>
<td>A-B+C</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Statement of comprehensive income</th>
<th>20XX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit or loss</td>
<td>A-B+C</td>
</tr>
<tr>
<td>Fair value changes</td>
<td>D</td>
</tr>
<tr>
<td>Reclassification adjustment on disposal</td>
<td>(C)</td>
</tr>
<tr>
<td>Total comprehensive income</td>
<td>A-B+D</td>
</tr>
</tbody>
</table>

Broad use of OCI

• OCI contains only some current remeasurements in **three** categories:
  – ‘Bridging items’
  – ‘Mismatched remeasurements’
  – ‘Transitory remeasurements’ (see next slide)

• Recycling
  – All bridging items and mismatched remeasurements
  – Some transitory remeasurements
    – if results in relevant information
‘Transitory remeasurements’

- Generally disaggregation (separate presentation) of components of an item income or expense
- Must meet all conditions:
  - Asset realised/liability settled over the long term
  - Current period remeasurement is expected to reverse fully, or change significantly, over the holding period of the asset or liability
  - Current period remeasurement enhances the relevance of profit and loss

**Broad use of OCI (2)**

- Profit or loss (default)
- OCI
  - Bridging
  - Mismatched
- Transitory remeasurements
  - Pensions
  - Own credit
  - Investments in equity instruments
  - PPE, intangible assets revaluation gains/losses
  - Others?
‘Transitory remeasurements’ (2)

Example – Pensions
20X1: Estimate of employee service cost is CU10 per year
20X2: Revised estimate of employee service cost is CU12 per year
- revision due to change in inflation forecast

<table>
<thead>
<tr>
<th>Impact on comprehensive income</th>
<th>20X2</th>
<th>Impact on Financial position</th>
<th>20X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit or loss</td>
<td>12</td>
<td>20X2 service cost</td>
<td>12</td>
</tr>
<tr>
<td>OCI: Pension liability</td>
<td></td>
<td>20X1 service cost</td>
<td>10</td>
</tr>
<tr>
<td>revaluation</td>
<td>2</td>
<td>20X1 ‘catch-up’</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>14</td>
<td>Pension liability</td>
<td>24</td>
</tr>
</tbody>
</table>

Relevant information about 20X2 service costs

Transitory effect of inflation is separately presented

Pensions and bridging items

- Remeasurements of net pension liabilities (assets) do not qualify as ‘bridging items’:
  - Difficult to determine basis to recycle
  - Cumulative amounts recognised in profit or loss do not reflect an alternative ‘measure’ of the liability
  - Measure should be meaningful, understandable, describable

- For example – using the previous slide:
  - Remeasured pension liability = CU24
  - Accumulated profit or loss:
    CU10 (20X1) + CU12 (20X2) = CU22
  - How do we describe the measurement of the pension liability reflected in accumulated profit or loss?
Alternative approach

• No recycling
• Total/subtotals determined at standards-level
• Cash flow hedge accounting?

Disclosures

• 2011 Agenda Consultation
• Discussion Forum on disclosure in January 2013
  – Feedback Statement with key messages and next steps issued in May 2013

<table>
<thead>
<tr>
<th>Short-term steps</th>
<th>Medium-term steps</th>
</tr>
</thead>
<tbody>
<tr>
<td>Narrow scope amendments to IAS 1</td>
<td>Research project on IAS 1, IAS 7 and IAS 8</td>
</tr>
<tr>
<td>Education material/guidance on</td>
<td>Standards-level disclosure review</td>
</tr>
<tr>
<td>materiality</td>
<td></td>
</tr>
<tr>
<td>New EDs disclosure requirements</td>
<td></td>
</tr>
</tbody>
</table>
Disclosures (2)

- Disclosure initiative in parallel with *Conceptual Framework* project
  - Projects inform each other

Conceptual Framework

- Materiality
- Objective of notes to the FS
- Communication principles
- Form of disclosure requirements

Disclosure initiative

**Conceptual Framework: Disclosure**

**Disclosures in the notes to the financial statements**

- Objective – supplement primary financial statements
- Focus on existing resources, obligations and other claims
- Information about management’s use of the entity’s resources

**Supplemental information about ....**

- Reporting entity
- Amounts presented in the primary financial statements
- Unrecognised assets and liabilities
- Risks arising from the entity’s assets and liabilities
- Methods, assumptions and judgements that affect amounts presented or otherwise disclosed.
Conceptual Framework: Disclosure

Materiality

- Problem is how it is applied in practice
- Do not amend the concept
- Consider how to provide additional guidance eg educational materials

Form of disclosure requirements

- Objectives
- Communication principles
- Financial statements in an electronic format

Financial statements in electronic format

- Financial statements can appear on paper or electronically
- Electronic format, eg through an entity’s website or using eXtensible Business Reporting Language (XBRL) makes accessing and ‘consuming’ financial information easier
  - XBRL was developed to provide a common, electronic format for business and financial reporting
- Discussion Paper notes that the IASB may need to consider impact of technology in developing presentation and disclosure requirements
IFRS XBRL programme

- The IFRS Taxonomy is the XBRL representation of the IFRSs (including IFRS for SMEs)
  - Purpose of IFRS XBRL programme is to streamline financial reporting to promote transparency and to improve the quality and comparability of business information
  - Taxonomies are the computer-readable 'dictionaries' of XBRL:
    - A taxonomy provides definitions for XBRL tags, it provides information about the tags, and it organises the tags so that they have a meaningful structure

IFRS Taxonomy 2013

- Annual IFRS Taxonomy
  - Based on IFRSs issued by 1 January 2013. Recent examples include:
    - Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities
    - Investment Entities
- Due process:
  - Reviewed by an external group of experts (the XBRL Quality Review Team or XQRT)
  - ED issued in January 2013
  - Final issued March 2013
European Transparency Directive: recent events

- EU Parliament: voted an amendment on 12 June 2013
- From 1 January 2020 all annual financial reports to be provided in a single electronic reporting format
  - Listed companies
- ESMA: develop draft technical regulatory standards to specify the electronic reporting format
  - submit to the EC by 31 December 2016
  - consider the current and future technological options eg XBRL
  - cooperate regularly and closely with the EBA and EIOPA, ensuring cross-sectorial consistency of work

International Financial Reporting Standards

Others
Other issues in Discussion Paper

- Elements
- Recognition & derecognition
- Measurement

Possible revised definitions

- Current definitions proved useful tool for many years except for some problems
- Propose to clarify definitions and add guidance

<table>
<thead>
<tr>
<th>Asset [of an entity]</th>
<th>Liability [of an entity]</th>
</tr>
</thead>
<tbody>
<tr>
<td>A present <strong>economic resource</strong> controlled by the entity as a result of past events</td>
<td>a present obligation of the entity to transfer an <strong>economic resource</strong> as a result of past events</td>
</tr>
<tr>
<td>An economic resource = a right, or other source of value, that is capable of producing economic benefits</td>
<td></td>
</tr>
</tbody>
</table>
Recognition & derecognition

- Recognition
  - Recognise items that meet definitions of elements, unless results do not provide useful information (relevant, faithful representation) or costs exceed benefits

- Derecognition:
  - None in the existing Conceptual Framework
  - Mirror image of recognition in most cases

Measurement

The objective of measurement is to faithfully represent relevant information about:
- the resources of the entity and claims against the entity, and changes to them
- how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s resources.

A single measurement basis will not provide the most relevant information

Consider information produced in both the statement of financial position and the statement of comprehensive income
Measurement (2)

Depends on:
- How an asset contributes to future cash flows (e.g., use, sell)
- How the entity will fulfill or settle the liability

Number of different measurements used should be minimum necessary

Consider cost-benefit

International Financial Reporting Standards

Topics in the Conceptual Framework

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.
### Topics in the *Conceptual Framework*

<table>
<thead>
<tr>
<th>Topics</th>
<th>In summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective of financial reporting</td>
<td>• Published 2010</td>
</tr>
<tr>
<td>Qualitative characteristics</td>
<td>• Published 2010</td>
</tr>
<tr>
<td>Reporting entity</td>
<td>• Will be developed from the ED 2010</td>
</tr>
<tr>
<td>Purpose &amp; status</td>
<td>• The <em>Conceptual Framework</em> will still be a guide for the IASB, not an IFRS</td>
</tr>
<tr>
<td></td>
<td>• May be useful for other stakeholders</td>
</tr>
<tr>
<td>Elements</td>
<td>• Assets/liabilities still describe real things</td>
</tr>
<tr>
<td></td>
<td>(resources/obligations)</td>
</tr>
<tr>
<td></td>
<td>• Additional guidance for some problems</td>
</tr>
</tbody>
</table>

---

### Topics (2)

<table>
<thead>
<tr>
<th>Sections</th>
<th>In summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities/equity</td>
<td>• Equity is still a residual</td>
</tr>
<tr>
<td></td>
<td>• Expand role of statement of changes in equity to show</td>
</tr>
<tr>
<td></td>
<td>the effect of different classes of equity claims</td>
</tr>
<tr>
<td>Recognition</td>
<td>• Remove probability</td>
</tr>
<tr>
<td>Derecognition</td>
<td>• New section</td>
</tr>
<tr>
<td>Measurement</td>
<td>• New section</td>
</tr>
</tbody>
</table>
## Topics (3)

<table>
<thead>
<tr>
<th>Sections</th>
<th>In summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presentation &amp; disclosure</td>
<td>• New section</td>
</tr>
<tr>
<td>OCI</td>
<td>• Retain profit/loss and OCI</td>
</tr>
<tr>
<td></td>
<td>• Define OCI</td>
</tr>
<tr>
<td>Other issues</td>
<td>• Going concern</td>
</tr>
<tr>
<td></td>
<td>• Business model</td>
</tr>
<tr>
<td></td>
<td>• Unit of account</td>
</tr>
</tbody>
</table>

## More information


More information (XBRL)

• XBRL website:
  – [http://www.ifrs.org/XBRL/Pages/XBRL.aspx](http://www.ifrs.org/XBRL/Pages/XBRL.aspx)

• Contact:
  – xbrl@ifrs.org

Questions
Technical break-out sessions:

Financial instruments: impairment

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RIANA WIESNER  
Senior Technical Manager  
IASB
Objectives of the project

- An expected credit loss model that incorporates forward looking information
- Model that faithfully reflects the economics of expected credit losses
- Single model to apply for all financial instruments not measured at FVPL
- Enhanced presentation and disclosures
The basis for the proposals

- The yield on financial instruments reflects initial credit loss expectations
- When expected credit losses exceed those initially expected, an economic loss is suffered
- This was best reflected in the 2009 ED

Proposals reflect this in a more cost effective way by:

- Recognising a portion of expected credit losses initially
- Recognising lifetime expected credit losses when significant deterioration in credit risk occurs

Overview of general model

<table>
<thead>
<tr>
<th>Change in credit quality since initial recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected credit losses recognised</td>
</tr>
<tr>
<td>12-month expected credit losses</td>
</tr>
<tr>
<td>Lifetime expected credit losses</td>
</tr>
<tr>
<td>Lifetime expected credit losses</td>
</tr>
<tr>
<td>Interest revenue</td>
</tr>
<tr>
<td>Gross basis</td>
</tr>
<tr>
<td>Gross basis</td>
</tr>
<tr>
<td>Net basis</td>
</tr>
<tr>
<td>Stage 1 Performing</td>
</tr>
<tr>
<td>Stage 2 Underperforming</td>
</tr>
<tr>
<td>Stage 3 Non-performing</td>
</tr>
</tbody>
</table>
When to recognise 12-month expected credit losses?

- When financial instrument is recognised initially
- No significant deterioration in credit quality; or
- Low credit risk (equivalent to ‘Investment grade’)

Expected credit losses will be recognised for all financial instruments at all times.

What are 12-month expected credit losses?

- Full lifetime expected credit losses that would result from default multiplied by probability of default in next 12 months
- Expected cash shortfalls in next 12 months
- Credit losses on assets expected to default in next 12 months
Stage 1: 12-month ECL

Concern: 12-month ECL do not capture credit losses that are expected to occur beyond 12 months

Example:
- Portfolio of 10-year loans with an initial 6-year interest-only period
- Defaults are expected in years 7-10 when principal payments have to be made

Stage 1: 12-month ECL

- Not only instruments expected to default in the next 12 months
- Consider the changes in credit risk over the life of instrument
- Portfolios, segments of portfolio or individual customers with significant credit deterioration transferred to Stage 2

Thus
- Stage 1 represents items where expectations of credit losses have not changed significantly
Low credit risk

• Operational simplification for high quality financial instruments
• Financial instrument considered low credit risk would remain in stage 1
• Therefore, no need to assess whether changes in credit risk have been significant
• Still need to update expected credit losses for changes in expectations even if in stage 1

How do you interpret ‘low credit risk’ for the purpose of the exception in the ED?

A. Relative to entity’s business and products
B. Equivalent to the level at which an entity originates specific products
C. Equivalent to an external credit rating of ‘investment grade’
D. Accounting policy choice
Low credit risk

- Equivalent to ‘Investment grade’ quality
- ‘Safe harbour’ for financial instruments such as high quality bonds
- Change in credit quality would not always lead to material difference in lifetime expected losses

But
- Not a hair-trigger – if the credit quality falls below investment grade, need to assess whether deterioration is significant (ie normal model applies)

Assessment of deterioration in credit quality

- Change in credit risk over the life of the instrument (ie probability of a default occurring)
  - Not changes in expected losses
  - Compared to credit risk at initial recognition
- Maturity matters
- Don’t require mechanical assessment
- Use information that is available without undue cost or effort

Expected credit losses are updated at each reporting date for new information and changes in expectations even if deterioration is not significant
Assessment of deterioration in credit quality

- In general assessment of significant deterioration on individual level
- Can perform on portfolio level if instruments have shared risk characteristics, such as
  - Credit risk ratings
  - Industry
  - Geographical location of borrower
  - Maturity

Assessment of deterioration in credit quality

Is it possible to assess significant deterioration on a portfolio/collective level?

- In general, assessment made on individual level
- Collective assessment if the same outcome as individual assessment, ie same risk characteristics, such as
  - Credit risk ratings
  - Industry
  - Geographical location of borrower
  - Remaining term to maturity
- Level of grouping will change as time reduces uncertainty of outcome
Assessment of deterioration in credit quality

As information emerges over time – entity is able to better distinguish credit quality of loans

Portfolio of home loans originated in a country.

Information emerges that a region in the country is experiencing tough economic conditions.

More information emerges and the entity is able to identify the particular loans that are in default or will imminently default.

Stage 1
Stage 2
Stage 3

Delinquency rebuttable presumption

- Objective is to identify **significant deterioration**
- Rebuttable presumption that is when payments are more than 30 days past due
- This is a lagging indicator
- Proxy for significant deterioration if no other borrower-specific information
- Can be rebutted if days past due are not associated with a significant change in credit risk
- However, cannot ignore information that suggest significant deterioration prior to 30 days delinquency
Measuring expected credit losses

Expected credit losses need to reflect:

• Probability weighted outcome
  – Must consider (at least) possibility that a default will occur and that a default will not occur

• Time value of money
  – Reasonable rate between (and including) risk-free rate and effective interest rate

Estimation will be less difficult for 12-month expected credit losses because of the shorter time horizon

Measuring expected credit losses

• Information used to measure expected credit losses and assess changes in credit:
  – Available without undue cost or effort
  – Historical, current and reasonable and supportable forecasts
  – Historical information must be updated
  – Delinquency information may be used

Particular measurement methods are not prescribed; nor must probability of default be explicitly included as an input
Measuring expected credit losses

Does ‘reasonable and supportable’ forecasts mean predicting the future over entire life of instrument?

• Not intended to mean use a crystal ball for the future
• For the near future use more granular information
  – Longer term revert to use of averages/ through the cycle data
• Use historic data and update for:
  – current information; and
  – future information that is readily available and supportable (eg GDP forecast)

What information could be considered in measuring forward-looking ECL?

• Borrower specific:
  – changes in operating results of borrower
  – technological advances that affect future operations
  – changes in collateral supporting obligation
• Macro-economic:
  – house price indexes, GDP, household debt ratios
• Internal default rates and probabilities of default
• External pricing:
  – Credit rating agency information

Information needs to be reasonable and supportable
Measuring expected credit losses

Consideration of time value of money

Reporting date
30/06/2X13

Default date

Cf1  Cf2  Cf3  Cf4

For purposes of the proposals, the expected credit losses should be discounted up to the reporting date.

Various models incorporate discounting up to the date of default – e.g., EAD/LGD based models.

When to calculate net interest

- Interest is usually calculated on the gross carrying amount i.e., before the loss allowance.
- Change to calculation on a net basis (i.e., on the amortized cost amount that is net of the loss allowance) when IAS 39 criteria for impairment are satisfied.
- Consistent with population considered impaired under IAS 39 today (excluding IBNR).
Exceptions to the general model

- **Simplified approach for trade and lease receivables**
  - Measure short-term trade receivables at lifetime expected losses
  - Policy election for long-term trade receivables and lease receivables

- **Assets credit-impaired on initial recognition**
  - Use credit-adjusted effective interest rate
  - Allowance balance represents changes since origination in lifetime losses

Exceptions designed to achieve a better balance between the benefits and costs

Loan commitments and financial guarantee contracts

- **Apply general deterioration model**

- Instruments that create a present legal obligation to extend credit
- Longest period considered is contractual period exposed to credit risk
- Estimate usage behaviour
- Expected credit losses presented as liability on the balance sheet
Proposed disclosures

Amounts
- Reconciliation
  - gross carrying amounts and associated losses
  - allowance account
- Gross carrying amount per credit risk grades
- Information on collateral held, modifications

Judgements – Inputs, assumptions and techniques to
- Estimate expected credit losses
- Determine and ‘objective evidence of impairment’
- Determine ‘significant deterioration in credit risk’
- Write off policies

Transition

• Retrospective application – as if always been effective
• Classify into Stages 1, 2 and 3 based on usual criteria (ie deterioration except for ‘investment grade’)
• If not possible without undue cost and effort, based on whether credit risk is low at transition date and at each reporting date, except when:
  - using delinquency - then historic information is available
Thank you
Technical break-out sessions:

Implementation update

WAYNE UPTON
Chairman
IFRS Interpretations Committee
and Director of International Activities
IASB
AGENDA

• Work in progress
• New issues
• Draft Interpretations
• Due process documents out for comment
• Annual Improvements cycles
• **IAS 19 Employee Benefits**
  - Determination of discount rate
  - Measurement of the net DBO for post-employment benefit plans with employee contributions

• **IAS 16 Property, Plant and Equipment / IAS 38 – Intangible Assets**
  - Contingent pricing of PPE & intangible assets
IAS 19 – Determination of discount rate

Description of the issue

• What is the underlying principle?
• Is the IAS 19 discount rate a risk-free rate?
• What does “high quality corporate bonds” mean?
• Government bonds or high quality government bonds?

Status

February 2013 IASB meeting:
• Par. 84 is the objective and par 83 is the way to achieve the objective
• Discount rate = time value of money + minimal/very low credit risk
• Government bonds should be high quality.

January 2013 IC meeting:
• the deepness of the market of euro HQCB should be assessed at the Eurozone level
IAS 19 – Measurement of net DBO for post-employment benefit plans with employee contributions

Description of the issue
• What is the accounting for employee contributions?
• How do they affect the calculation of the DBO (including the effect of back-end and front-end loaded)?

Status
• The IASB discussed issue and proposes:
  • narrow-scope amendment to IAS 19:
    Employee contributions are a reduction in service cost, if they are linked solely to the employee’s service in that period

Next step
• The staff will prepare an Exposure Draft

IAS 16/IAS 38 – Variable payments for the separate acquisition of PPE and intangible assets

Description of the issue
• How to account for variable payments for the separate acquisition of PPE and intangible assets?

Status
• January 2013: IC tentatively agreed to propose amendments to IAS 16, IAS 38 and IAS 39

Proposed solution
• Adjustments to the amount of a financial liability other than those corresponding to finance costs would be recognised as a corresponding adjustment to the cost of the asset to the extent that IAS 16 or IAS 38 requires so.
New issues

- IFRS 10 – *Consolidated Financial Statements*
  - Classification as liability or equity of puttable instruments that are non-controlling interests.

- IAS 28 – *Investments in Associates and Joint Ventures*
  - Elimination of gains arising from a transaction between an entity and its joint venture.

- IFRS 5 – *Non-current Assets held-for-sale and Discontinued Operations*
  - Classification as held-for-sale if disposal method is through an initial public offering (IPO) and accounting requirements when disposal method changes.
Classification as liability or equity of puttable instruments that are non-controlling interests

Description of the issue

- How should puttable instruments that are non-controlling interests be classified in consolidated financial statements? Equity or liability?

Status

- To be discussed at forthcoming IC meeting. No divergence in practice noted.
- Staff view: puttable instruments that are NCI should be classified as liability.
- The exception in IAS 32.16A-16D requiring that particular puttable instruments are classified as equity applies only to the issuing entity’s own financial statements.

Elimination of gains arising from a transaction between an entity and its joint venture

Description of the issue

- An entity leases its fixed asset to its joint venture
- The gain from this transaction exceeds the carrying amount of the entity’s investment in the joint venture
- What amount should be eliminated when the entity prepares its financial statement using the equity method?

Status

- Divergence in practice:
  - View A: eliminate the gain until the investment reduces to zero
  - View B: eliminate all of the entity’s share of the gain
Elimination of gains arising from a transaction between an entity and its joint venture (continued)

Status

- **View A** analogises the requirement that an entity should discontinue recognising its share of further losses when the entity’s share of losses of its joint venture exceeds its interest in the joint venture.
- **View B** is based on the requirement that an entity’s share in its joint venture’s gains or losses resulting from ‘upstream’ or ‘downstream’ transactions should be eliminated.
- IFRS IC will discuss the issue in its March 2013 meeting.
- Will be discussed in March 2013 meeting (see attachment – AP2A).

Classification as HFS if disposal method is IPO & accounting when disposal method changes

Description of the issue

- **Case 1:** A disposal plan that is intended to be achieved by means of an initial public offering (IPO) and the prospectus has not been approved by the securities regulator;  
  *Question:* would this plan qualify as held-for-sale?
- **Case 2:** An entity changes its disposal plan from a plan that previously qualified as held for sale to a plan to spin off the disposal group and distribute a dividend in kind to its shareholders;  
  *Question:* does this change qualify as a change to a plan of sale?

Status

- To be discussed at forthcoming IC meeting.
Classification as HFS if disposal method is IPO & accounting when disposal method changes (continued)

Staff view

• Prospectus approval is needed to consider the disposal to be highly probable (par. 8 IFRS 5)

• Change of method of disposal does not necessarily qualify as change of plan for sale because the sale (or distribution) has not ceased to be highly probable (par 26 IFRS 5).

• In addition:
  • IFRS 5 does not distinguish between methods of disposal.
  • IFRS 5 has similar requirements to classify a disposal group as held for sale (par. 7–9) and as held for distribution (par. 12A).
Draft Interpretations

- DI/2012/1 – Levies Charged by Public Authorities on Entities that Operate in a Specific Market
  - Issued in May 2012
  - Comments by 5 September 2012
- DI/2012/2 – Put Options Written on Non-controlling Interests
  - Issued in May 2012
  - Comments by 1 October 2012

Levies Charged by Public Authorities on Entities that Operate in a Specific Market

Description of the issue
- What is the accounting for levies imposed by governments on entities in the F/S of the entity paying the levy?
- In particular, when should the liability to pay a levy be recognised?

Status
- May 2012: IC published draft interpretation
- January 2013: IC analysed comments received

Next step
- March 2013: IC will vote on the final interpretation
Levies (continued)

Accounting (consensus)

• The obligating event that gives rise to a liability is the activity that triggers the payment of the levy
• An entity does not have a constructive obligation to pay a levy that will be triggered by operating in the future
• The liability is recognised progressively if the obligating event occurs over a period of time
• The accounting for levies with minimum thresholds is consistent with the principles established above
• The same recognition principles are applied in the annual financial statement and in the interim financial report

Put options written on NCI

Description of the issue

• How to subsequently measure in the parent's consolidated financial statements:
  • the financial liability that arises when a parent entity is obliged to purchase the shares of its subsidiary (that are held by an NCI shareholder) for cash or for another financial asset (NCI put)?

Status

• May 2012 – IC published draft interpretation (DI/2012/2)
• January 2013 – IC analysed comments received.

Next step

• Staff will report the IC’s views at March IASB meeting.
Put options written on NCI (continued)

Accounting (consensus)

• **Initial measurement**: financial liability at present value of redemption amount.
• **Subsequent measurement**: all changes in the measurement of that financial liability should be recognised in **profit or loss** in accordance with IAS 39 and IFRS 9.

Interpretations Committee’s recommendation

• Reaffirm consensus reflects current IFRS requirements…
  …but superior answer would be to apply derivative accounting to put options and forward contracts written on an entity’s own equity.
Due Process documents out for comment

- ED/2013/2 Novation of OTC derivatives and continuation of hedge accounting (Feb 2013; comments by 02/04/13)
  - Proposed amendments to IAS 39 and IFRS 9
- ED/2012/3 – Equity method: Share of other net asset changes IAS 28 (Nov 2012; comments by 22/03/13)
  - Proposed amendments to IAS 28
- ED/2012/6 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Dec 2012; comments by 23/04/13)
  - Proposed amendments to IFRS 10 and IAS 28
- ED/2012/7 Acquisition of an Interest in a Joint Operation (Dec 2012 comments by 23/04/13)
  - Proposed amendments to IFRS 11

Novation of derivatives and continuation of hedge accounting

Why the need for an amendment?
- New regulation to mandate central clearing of over-the-counter (OTC) derivatives, prompted by a G20 commitment
- A novation of the hedging instrument to a central counterparty results in the discontinuation of the hedge accounting

Areas of diversity/current views in practice
- No divergent views in practice
- Concern about the financial reporting effect arising from new regulation
Novation of derivatives and continuation of hedge accounting (continued)

Proposed amendment

- Introduces an exception to the requirement for the discontinuation of hedge accounting in IAS 39.
- An entity continues hedge accounting in a circumstance where a derivative, which has been designated as a hedging instrument, is novated from one counterparty to a central counterparty as a consequence of laws or regulations if specific conditions are met.
- Equivalent requirements are proposed to be included in the forthcoming hedge accounting chapter in IFRS 9 Financial Instruments.

Equity method: share of other net asset changes

Why the need for an amendment?

- IAS 28.10 is not clear whether, and if so, where, the investor should account for “other net asset changes” of the investee

  (Other net asset changes are changes in the net assets of the investee other than profit or loss or OCI or distributions received)

Proposed amendment

- Investor should:
  - recognise other net asset changes in its equity
  - reclassify to profit or loss the amount recognised in equity when it discontinues the use of the equity method
Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

Why the need for an amendment?

• There is a conflict between IAS 27 and SIC-13: IAS 27 requires a full gain or loss recognition on the loss of control of a subsidiary, whereas SIC-13 requires a partial gain or loss recognition in transactions between an investor and its associate or joint venture.
• This conflict will remain when IFRS 10 replaces IAS 27 and when SIC-13 is included into IAS 28 (2011).

Areas of diversity/current views in practice

• Entities apply either SIC-13 or IAS 27 to the contribution of a subsidiary to a joint venture/associate.

Proposed amendments

• The IASB proposes to amend IAS 28 (2011) and IFRS 10 so that:
  • A full gain or loss is recognised on the loss of control of a business (regardless of whether that business is housed in a subsidiary or not).
  • A partial gain or loss is recognised in accounting for the sale or contribution of a group of assets or a subsidiary that does not constitute a business.
Acquisition of an Interest in a Joint Operation

Why the need for an amendment?

- **No guidance** in IFRS 11 on the accounting, by a joint operator, for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business, as defined in IFRS 3 *Business Combinations*.

- **Current views applied in practice** to address the issue:
  - **View 1.** Apply the principles on business combinations accounting in IFRS 3 and in other Standards;
  - **View 2.** Allocate the total cost of acquiring interests in jointly controlled operations or assets on the basis of relative fair values;
  - **View 3.** Apply the principles of business combinations accounting only to issues not addressed in other Standards.

Areas of diversity in practice (continued)

- **Recognition of a premium paid in addition to the fair value of the identifiable net assets:**
  - recognise as an asset? or
  - allocate it to identifiable net assets on the basis of relative fair values?

- **Deferred tax assets and deferred tax liabilities that arise from the initial recognition of assets and liabilities:**
  - recognise on the acquisition of the interests in the jointly controlled operation or assets?
  - do not recognise because of initial recognition exceptions?

- **Acquisition-related costs**
  - capitalise?
  - recognise as an expense?
Proposal in the Exposure Draft (continued)

- Apply the relevant principles for business combinations accounting in IFRS 3 and other Standards, which include:
  - measuring identifiable assets and liabilities at fair value
  - recognising acquisition-related costs as expenses in the periods in which costs are incurred and the services are received
  - recognising deferred tax assets and deferred tax liabilities that arise from the initial recognition of assets and liabilities
  - recognising the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill.

Clarification of Acceptable Methods of Depreciation and Amortisation

Current guidance

- IAS 16 and IAS 38 permit the use of a variety of depreciation/amortisation methods:
  - Straight-line method
  - Diminishing balance method
  - Units of production method

- Principle: a depreciation/amortisation method is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset.
Clarification of Acceptable Methods of Depreciation and Amortisation

Request for clarification

- Can an entity use a revenue-based method?

Proposal

- Prohibit a method that uses revenue generated from an activity that includes the use of the asset

Rationale

- A revenue-based method does not reflect the pattern of consumption of future economic benefits embodied in the tangible or intangible asset.
Current cycles

• The ongoing cycles are:
  – 2011-2013 (stage: comment letter analysis)
  – 2010-2012 (stage: comment letter analysis)
  – 2012-2014 (stage: collecting issues)

• Annual Improvements webpage:

2011-2013 cycle (ED Nov 2012)

Issues
• IFRS 1: Meaning of effective IFRSs
• IFRS 3: Scope exceptions for joint ventures
• IFRS 13: Scope of portfolio exception
• IAS 40: Clarifying the interrelationship of IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property

Deadline for comments: 18 February 2013
Status: About 60 comment letters received
Next steps: IC May 2013 – Presentation of comment letters analysis
2010-2012 cycle (ED May 2012)

Overview

• ED Annual Improvements to IFRSs 2010-2012 Cycle:
  – ED comprises 11 proposed amendments to 11 IFRSs (including a proposed amendment to IFRS 9)
  – IASB and IFRS IC collected issues for inclusion in ED from November 2010 until November 2011
  – ED published on 3 May 2012 with a comment period until 5 September 2012
• Current Status: IASB and IFRS IC are discussing comment letter analyses in several meetings

Issues already discussed by IASB

• Issues approved for finalisation:
  – IFRS 2—Definition of ‘vesting condition’
  – IFRS 8—Aggregation of operating segments
  – IFRS 8—Reconciliation of the total of the reportable segments’ assets to the entity’s assets
  – IFRS 13—Short-term receivables and payables

• Issues rejected for annual improvements:
  – IAS 12—Recognition of deferred tax assets for unrealised losses
    – Issues that go beyond the scope of annual improvements need to be addressed
  – IAS 36—Harmonisation of disclosures for value in use and fair value less costs of disposal
    – Because of overlap included in project ‘Recoverable Amounts Disclosures on Non-Financial Assets’
2010-2012 cycle (ED May 2012) (continued)

Issues to be discussed by IASB

- **Issues recommended for finalisation by IFRS IC:**
  - IAS 16 & IAS 38—Revaluation method—proportionate restatement of accumulated depreciation
  - IAS 24—Key management personnel

- **Issue recommended for rejection by IFRS IC:**
  - IAS 1—Current/non-current classification of liabilities
    - Issues should be addressed in narrow-scope project to amend IAS1 because so-called ‘10 per cent test’ is not appropriate for presentation purposes

- **Issue requiring (further) discussion by IFRS IC:**
  - IFRS 3—Accounting for contingent consideration in a business combination
  - IAS 7—Interest paid that is capitalised

2012-2014 cycle (ED tentative Q3)

- **IAS 34 Interim Financial Reporting**—Disclosure of information ‘elsewhere in the interim report’
  - To require the inclusion of a cross-reference from the interim financial statements to the location of the information “elsewhere in the interim report” in paragraph 16A of IAS 34

- Other issues that will be collected through Q1 and Q2 (2013)
Expressions of individual views by members of the IASB and its staff are encouraged.

The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.
Insurance contracts

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Member
IASB

ANDREA PRYDE
Technical Principal
IASB

IZABELA RUTA
Assistant Technical Manager
IASB

ANDREA SILVA
Technical Associate
IASB
Background to insurance contract proposals:
No comprehensive IFRS today

IFRS 4 Insurance Contracts is an interim Standard
- Permits continuation of a wide variety of accounting models
- Requires disclosures to enhance comparability and to understand reported amounts

Revised Exposure Draft (ED) next step toward final Standard
- Builds on previous consultations
- Seeks feedback on changes to previous proposals
- Focus on operational and reporting complexity of revised proposals

Aim to finalise Standard by early 2015
- Revised ED published June 2013
- Comments to be received by 25 October 2013
- IASB will redeliberate during 2014
- Standard effective from 2018
**Background to insurance contract proposals: Improving existing accounting**

<table>
<thead>
<tr>
<th>Existing issues</th>
<th>How our proposals improve accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variety of accounting treatments depending on type of contract and type of</td>
<td>Consistent accounting for all insurance contracts by all companies (not just</td>
</tr>
<tr>
<td>company that issues the contracts</td>
<td>insurance companies)</td>
</tr>
<tr>
<td>Estimates for long duration contracts not updated</td>
<td>Estimates updated to reflect current market-based information</td>
</tr>
<tr>
<td>Discount rate based on estimates of investment returns does not reflect</td>
<td>Discount rate reflects characteristics of the cash flows of the contract</td>
</tr>
<tr>
<td>economic risks of insurance contract</td>
<td></td>
</tr>
<tr>
<td>Lack of discounting for measurement of some contracts</td>
<td>Measurement of insurance contract reflects discounting where significant</td>
</tr>
<tr>
<td>Little information about economic value of embedded options and guarantees</td>
<td>Measurement reflects information about full range of possible outcomes</td>
</tr>
</tbody>
</table>

*How our proposals improve accounting:*

- Improved consistency by requiring similar treatments across all companies.
- Ensures updated estimates reflect current market information.
- Aligns discount rate with economic risks of the insurance contract.
- Provides a more accurate valuation of insurance contracts.

**Measurement of insurance contract has two components:**

- **Net contract asset or liability**: Represents the expected contract profit.
- **Contractual service margin**: Represents the uncertainty about future cash flows.

**Contractual service margin** represents expected contract profit.

**Fulfilment cash flows** represent a current, updated estimate of amounts the company expects to collect from premiums and pay out for claims, benefits and expenses, adjusted for risk and time value of money.

*Depending on the timing of payments relative to coverage provided.*
Background to insurance contract proposals: Up-to-date information about performance

Net contract asset or liability

- Fulfilment cash flows
  - Expected cash flows from premiums and claims and benefits
- An assessment of the uncertainty about the amount of future cash flows
- An adjustment that converts future cash flows into current amounts

Statement of Comprehensive Income

<table>
<thead>
<tr>
<th>20XX</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Insurance contracts revenue</td>
<td>X</td>
</tr>
<tr>
<td>Incurred claims and expenses</td>
<td>(X)</td>
</tr>
<tr>
<td>Operating result</td>
<td>X</td>
</tr>
<tr>
<td>Investment income</td>
<td>X</td>
</tr>
<tr>
<td>Interest on insurance liability</td>
<td>(X)</td>
</tr>
<tr>
<td>Investment result</td>
<td>X</td>
</tr>
<tr>
<td>Profit or loss</td>
<td>X</td>
</tr>
<tr>
<td>Effect of discount rate changes on insurance liability</td>
<td>(X)</td>
</tr>
<tr>
<td>Total comprehensive income</td>
<td>XX</td>
</tr>
</tbody>
</table>

Background to insurance contract proposals: What will disclosures show?

Amounts
- Expected present value of future payments & receipts
- Changes in risk during the period
- Changes in unearned profit during the period
- Effects of new contracts written in the period

Judgements
- Processes for estimating inputs and methods used
- Effect of changes on methods and inputs used
- Explanation of reason for change, identifying type of contracts affected

Risks
- Nature and extent of risks arising from insurance contracts
- Extent of mitigation of risks arising from reinsurance and participation features
- Quantitative information about exposure to credit, market and liquidity risk
IASB seeks feedback on targeted aspects

Presentation proposals
(information in statement of profit or loss and other comprehensive income)
- Interest expense
- Insurance contract revenue and expenses

Measurement proposals
- Reporting changes in unearned profit associated with future services
- Cash flows expected to vary directly with returns on underlying items

Approach to transition
- Applying new Standard for first time

Issue: Presentation of interest expense on insurance contracts in profit or loss

Should companies be required to separate the results from underwriting and investment activities from the effects of the changes in discount rates?
Our proposal: Interest expense presented in profit or loss using locked in discount rate

Statement of Comprehensive Income

<table>
<thead>
<tr>
<th>Description</th>
<th>20XX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating (underwriting) result</td>
<td>X</td>
</tr>
<tr>
<td>Investment income*</td>
<td>X</td>
</tr>
<tr>
<td>Interest expense (on insurance liability)</td>
<td>(X)</td>
</tr>
<tr>
<td>Investment result</td>
<td>X</td>
</tr>
<tr>
<td>Profit or loss</td>
<td>X</td>
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<tr>
<td>Effect of discount rate changes on insurance liability***</td>
<td>(X)</td>
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<tr>
<td>Total comprehensive income</td>
<td>XX</td>
</tr>
</tbody>
</table>

*Includes interest revenue and gains and losses on financial assets measured at fair value through other comprehensive income

**Cost view uses the discount rate determined at contract inception, and current view uses the current discount rate at reporting date

*** The effect of discount rate changes reconciles the current view and the amortised cost view of performance, assuming financial assets are measured at fair value through other comprehensive income

Profit or loss
Reflects the profit or loss from services using a cost view of the time value of money**

Total comprehensive income
Reflects the profit or loss of providing services using a current view of the time value of money**

Interaction with proposals for financial assets: Balance sheet

Balance sheet: based on current and fair values

<table>
<thead>
<tr>
<th>Description</th>
<th>20XX</th>
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<tbody>
<tr>
<td>Assets</td>
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<tr>
<td>Financial assets *</td>
<td>XX</td>
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<tr>
<td>Other assets *</td>
<td>XX</td>
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<tr>
<td>Total assets</td>
<td>XXX</td>
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<tr>
<td>Liabilities</td>
<td></td>
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<tr>
<td>Insurance contract liabilities</td>
<td>XX</td>
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<td>Other liabilities</td>
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<tr>
<td>Total liabilities</td>
<td>XX</td>
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<tr>
<td>Equity</td>
<td>XX</td>
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<tr>
<td>Total equity and liabilities</td>
<td>XXX</td>
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</tbody>
</table>

*This example assumes that the insurance contracts are in a liability position and are backed predominantly by debt instruments measured at FVOCI. However, insurance contracts could be backed by other assets (including financial assets) that could instead be measured at amortised cost or fair value through profit or loss.
Interaction with proposals for financial assets: Statement of comprehensive income

**Statement of Comprehensive Income**

<table>
<thead>
<tr>
<th>20XX</th>
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<tbody>
<tr>
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**Operating (underwriting) result**

<table>
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**Interest revenue (financial assets measured at FVOCI)**

<table>
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<tr>
<th>X</th>
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**Interest expense (insurance contract liability)**

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**Impairment loss (financial assets measured at FVOCI)**

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<th>(X)</th>
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**Gains and losses (financial assets measured at FVOCI)**

<table>
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**Investment result**

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**Profit or loss**

<table>
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**Fair value changes in financial assets at FVOCI**

<table>
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<tr>
<th>X</th>
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**Effect of discount rate changes on insurance liability**

<table>
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**Other comprehensive income**

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**Total comprehensive income**

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</table>

**Cost view uses the discount rate determined at contract inception, assuming all financial assets are measured at FVOCI, and current view uses the current discount rate at reporting date.**

**Interest on financial assets based on expected contractual cash flows (same as amortised cost)**

**Realised gains and losses (recycled from OCI)**

**Interest:** Interest revenue is same as amortised cost (AC) - effective interest rate method, and interest expense is determined on a cost** view

**Other comprehensive income:** Reconciles AC and FV amounts for financial assets, assuming those assets are measured at FVOCI, and reconciles cost view with current view** for insurance liabilities

Contrasting the alternatives: Interest expense presentation in profit or loss

**Our proposal**

- Separates results from underwriting and investing activities from the effect of changes in discount rates in a way that aligns to proposals for financial assets at fair value through other comprehensive income. This enables a cost-based profit or loss and a current measurement balance sheet to be determined that interact and fit with the IFRS 9 proposals for financial assets

**Alternative**

- Present the changes in the insurance contract liability arising from changes in the discount rate in profit or loss. This:
  - avoids reporting complexity
  - provides transparent information about all economic gains and losses
  - permits greater reduction of unavoidable mismatches
Issue: Insurance contract revenue and expense

Should a company show information about gross performance rather than net margin?

If gross performance is more useful, should information be consistent with revenue and expense for other transactions?

How revenue relates to changes in the measurement of the insurance contract

Insurance contract revenue

- Net liability for the remaining coverage at start of year
- Premiums received (incl deposit component)
- Unwind of discount (incl change in discount rate)
- Expected claims and expenses
- Change in contractual service margin
- Change in the adjustment
- Repayment of deposit component

Net liability for the remaining coverage at end of year
Proposed change to presentation does not affect operating result

Summarised margin presentation

Change in risk adjustment
+ Change in contractual service margin
± Experience adjustments
= Operating result

Proposed presentation: Gross performance

Change in risk adjustment
+ Change in contractual service margin
± Claims/expenses expected
- Claims/expenses incurred
= Operating result

Insurance contracts revenue
- Claims/expenses incurred
= Operating result

When should premiums be reported as revenue?
Level premium term life contract

• Assumptions:
  – Portfolio of term life contracts issued to 40 year olds
  – Expected claims/benefits are 10,000; premiums are due 2,000 each 5 year period
  – Ignores premiums ‘allocated’ to the margins, payment of acquisition costs and payment of maintenance and benefits expense
  – Assumes no lapses, no discounting and no investment component
Contrasting the alternatives: Gross performance measures

Our proposal: Gross performance measures
- Present insurance contract revenue and incurred claims/expenses
- Enables results from insurance services to be compared to results of other services provided or goods sold (by insurance or non-insurance companies)

Alternative: Net performance measures
- Present operating result, disaggregated into:
  - Change in contractual service margin
  - Change in risk
  - Changes in expected cash flows for current and past service
- Highlights drivers of performance. Also simpler to apply as avoids need to identify deposit component

Issue: Reporting changes in unearned profits associated with future services

Changes in estimates of cash flows affect the amount of profit the company expects to earn for providing future services. Should such changes in estimates be reflected in the period of change or as future services are provided?
Reporting changes in unearned profits associated with future services

Our proposal
Any changes in estimates relating to the profits to be earned from an insurance contract are recognised over the period in which that profit is earned.

Alternative
All changes in estimates are recognised immediately in profit or loss.

Contrasting the alternatives: Changes in unearned profits associated with future services

Our proposal
Adjust contractual service margin for changes in future cash flows related to future services
- Better reflects that these changes affect unearned profit for providing future services
- Results in consistency between initial and subsequent measurement of contractual service margin
- For periods after change in estimate, updated estimates included in future operating results as services are provided
- Consistent with revenue recognition model and premium-allocation approach

Alternative
- Changes in estimates for both past and future services represent economic events during the period and should immediately be recognised in profit or loss
- Immediately recognising in profit or loss changes in expected future profits provides transparent, relevant information of changes in estimates since entering into the contract
- For periods after change in estimates, profit based on original estimates for future services
- Consistent with balance sheet view and IFRS 9
Issue: Contracts with cash flows expected to vary directly with returns on underlying items

If an insurance contract specifies a link to returns on underlying items the company is required to hold, there can be no economic mismatch between the cash flows that vary directly with returns on underlying items and those returns.

How do we portray that fact?

Measurement and presentation exception for contracts with cash flows expected to vary directly with returns on underlying items

- No possibility of economic mismatch if the contract specifies that the company is required to hold underlying items and payments to the policyholder must vary directly with returns on underlying items

- Measured using general requirements of the Standard. However, all changes in value of cash flows that vary indirectly with underlying items are presented in profit or loss

- Eliminate mismatch by measuring and presenting cash flows in the same way as underlying items
Contrasting the alternatives: Contracts with cash flows expected to vary directly with returns on underlying items

Our proposal
- Measuring applicable cash flows by reference to the underlying items reflects extent to which the company will fulfil the obligation by delivering a value equivalent to the underlying item to the policyholder
- Eliminates all mismatches between measurement of the insurance liability and the underlying items

Alternative
- Measuring the insurance contract liability using fulfilment cash flows (with no adjustment to reflect contractual linkage to underlying items) would:
  - result in measuring all insurance contracts on same basis
  - substantially eliminate measurement mismatches when underlying items are measured at fair value

Issue: Applying proposals for first time

The challenge for first-time application is measuring the contractual service margin at the date of transition.

How do we balance verifiability of the amount recognised at transition date with comparability between contracts issued prior to and after transition date?
Applying proposals for first time

Contractual service margin
(Contract profit)

Fulfilment cash flows

- Expected cash flows from premiums and claims and benefits
- An assessment of the uncertainty about the amount of future cash flows
- An adjustment that converts future cash flows into current amounts

Needs to be estimated

Estimate as if the Standard had always been applied, with simplifications that maximise the use of objective data if necessary

Can be directly measured

Measure on date of first time application

Contrasting the alternatives: Initial application

Our proposal

- Estimating and recognising contractual service margin on transition enables users to compare profitability of existing contracts with new contracts

Alternative

- Setting contractual service margin to zero and measuring liability as fulfilment cash flows would be simple, cost little and would not involve subjective information in determining the margin
Balancing benefits against complexity

Cost for entities arising from greater operational complexity and costs for users of financial statements in understanding more complex information.

More faithful representation of features of some insurance contracts.

Timetable

- Late June 2013: Revised Exposure Draft
- Late Oct 2013: Comment letter deadline
- H1 2014: Board debates issues
- Early 2015: Issue IFRS
- 1 Jan 2018*: Earliest effective date

* At least 3 years to implement proposals
For more information…

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  – go.ifrs.org/insurance_contracts
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• Email us:
  insurancecontracts@ifrs.org

Resources on IASB website
• IASB Update
• Project podcasts
• Investor resources
• High level summary of progress
• Detailed summary of IASB’s tentative decisions
• Topic reports on IASB’s tentative decisions

…more to follow
Technical break-out sessions:

Conceptual Framework (Part 2):
  elements and measurement

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  Member
  IASB

PETER CLARK
  Director of Research
  IASB

KRISTY ROBINSON
  Technical Principal
  IASB
Session overview

• Why?
• Where are we?
  – Timetable
• Focus on:
  – Definition of elements
  – Recognition & derecognition
  – Boundaries between liabilities and equity
  – Measurement
• Questions
Why?

- Previous joint project with FASB suspended in 2010
- Agenda consultation
  - Priority project
- Purpose of Conceptual Framework project
  - Not a fundamental rethink
  - Update, improve and fill in gaps
  - Focus on problems in standard-setting

Where are we?

- Objective of financial reporting
- Qualitative characteristics
  - Completed

ED
- Reporting entity

Now
- Everything else on financial statements
**Objective of financial reporting**

To provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. (OB 2)

- Information about resources and claims against the entity, and changes to them
- Information to assess effective and efficient management of resources

---

**Qualitative characteristics**

- Fundamental qualitative characteristics
- Useful
- Enhancing qualitative characteristics
Fundamental QCs

- Relevance
- Faithful representation

Useful

Enhancing QCs

- Usefulness
- Comparability
- Understandability
- Verifiability
- Timeliness
Timetable

- Jul 2013: Issue DP, 6-month comment period
- Q4 2014: Issue ED
- End 2015: Final

International Financial Reporting Standards

Elements and recognition/derecognition

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.
### Existing definitions

<table>
<thead>
<tr>
<th>Asset [of an entity]</th>
<th>Liability [of an entity]</th>
</tr>
</thead>
<tbody>
<tr>
<td>• a <strong>resource</strong> controlled by the entity</td>
<td>• a <strong>present obligation</strong> of the entity</td>
</tr>
<tr>
<td>• as a result of <strong>past events</strong></td>
<td>• arising from <strong>past events</strong></td>
</tr>
<tr>
<td>• from which <strong>future economic benefits</strong> are <strong>expected</strong> to flow to the entity</td>
<td>• the settlement of which is <strong>expected</strong> to result in an outflow from the entity of resources embodying <strong>economic benefits</strong></td>
</tr>
</tbody>
</table>

Proved useful tool for many years but for some problems

### Problems with existing definitions and recognition

- Risk of confusing:
  - the resource or obligation, with
  - the inflows or outflows of economic benefits that the resource or obligation may generate

- What does ‘expected’ mean? How about probability from the recognition criteria?

- More guidance needed?
  - What is a resource?
  - What is an obligation?
### Possible revised definitions

<table>
<thead>
<tr>
<th>Asset [of an entity]</th>
<th>Liability [of an entity]</th>
</tr>
</thead>
<tbody>
<tr>
<td>A present <strong>economic resource</strong> controlled by the entity as a result of past events</td>
<td>a present <strong>obligation</strong> of the entity to transfer an <strong>economic resource</strong> as a result of past events</td>
</tr>
<tr>
<td>An economic resource = a right, or other source of value, that is capable of producing economic benefits</td>
<td></td>
</tr>
</tbody>
</table>

### Problems with expected & probability

- **Existence uncertainty**
  - Does the resource or obligation exist?
  - Eg litigation

- **Outcome uncertainty**
  - How likely is it that the resource (or obligation) will produce inflows or outflows?
  - Eg options
Possible approaches to uncertainty

**Existence uncertainty**
- Most cases, it is clear
- But when unclear, IASB will determine threshold

**Outcome uncertainty**
- No specific probability threshold
- But, in some cases, the IASB may conclude that recognition does not:
  - provide relevant information
  - pass a cost/benefit test [see recognition]

Summary of further guidance proposed

**To support asset definition**
- meaning of ‘economic resource’
- meaning of ‘controlled’

**To support liability definition**
- constructive obligations
- impact of future events

**To support both definitions**
- reporting substance of contractual rights and obligations
- executory contracts
Liabilities

• Some problems in standard-setting
  – Impact of future events
  – Economic compulsion vs constructive obligations

Problem with future events

Does a present obligation exist if the obligation is conditional on an entity’s future actions?

Events whose occurrence is outside the entity’s control

✓

The entity’s own future actions

?
3 approaches to future events that depends on future actions

1. Present obligation arises from past event and
   - Strictly unconditional
   - Not supported

2. Present obligation arises from past events and practically unconditional

3. Arise from past events but may be conditional on the entity’s future actions

Constructive obligations – Additional guidance

Entity must have a duty or responsibility to another party.

Other party must be one who would benefit from the entity fulfilling its duty or responsibility.

As a result of entity’s past actions, the other party can reasonably rely on entity to discharge duty or responsibility.
Reporting the substance of contracts

- View group of contracts as a whole if designed to achieve an overall objective
- Consider all terms – whether explicit or implicit
- Disregard terms with no commercial substance
  - ‘no discernible effect on economics of contract’
- If option holder has only one remaining option, that option is a requirement.

Summary of further guidance proposed

To support asset definition
- meaning of ‘economic resource’
- meaning of ‘controlled’

To support liability definition
- constructive obligations
- impact of future events

To support both definitions
- reporting substance of contractual rights and obligations
- executory contracts
What is recognition?

Identify the assets, liabilities, income, expenses

Depiction in words and numbers

Existing criteria:
• Meets definitions
• Probable
• Measured reliably

Recognition: proposed approach

• Generally, recognising items that meet definitions provide more useful information
• But, there may be cases when an entity should not recognise some asset or liability:
  – If recognising would provide users with information that is not relevant or not sufficiently relevant to justify the cost
  – If no measurement of the asset or liability would result in a faithful representation of the asset or liability, or of changes in the asset or liability.
Derecognition

- Nothing in the existing *Conceptual Framework*
- Is derecognition the mirror image of recognition or does history matter?
- Mirror image
  - Derecognise an asset or liability if it is no longer an asset or liability of the entity
- History matters = stickiness
  - Keep recognising an asset or liability in some cases even if it is no longer an asset or liability of the entity

Example

Entity A transfers an asset with a carrying amount of CU70 to Entity B for its fair value (CU100). At the same time, Entity A agrees to repurchase that asset for CU100 in 1 year.
(For simplicity, ignore time value of money)

**Balance sheet**

<table>
<thead>
<tr>
<th>Mirror image</th>
<th>History matters</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash 100</td>
<td>Asset 70</td>
</tr>
<tr>
<td>Repo 0</td>
<td>Cash 100</td>
</tr>
<tr>
<td></td>
<td>Liability 100</td>
</tr>
<tr>
<td>Gain 30</td>
<td></td>
</tr>
</tbody>
</table>

However, if entity A had never owned the asset but entered into a forward purchase contract with entity B, it would simply recognise the forward contract (initially at zero)
Proposals for derecognition

Derecognition is the mirror image of recognition but if the entity retains the components of the asset or liability, consider how best to portray the changes that results from the transactions:

- Disclosures
- Presentation eg different line items
- Continued recognition

- Reasons why mirror image is default
  - Consistent with recognition criteria
  - Same accounting treatment, irrespective of sequence

- Portraying changes in the rights & obligations
  - Standards-level issue
  - Depict both the financial position and the transaction

Liability vs Equity?

- Existing definition: the residual interest in the assets of the entity after deducting all its liabilities
- Problem: to distinguish liabilities from equity instruments, standards (IAS 32) use complex criteria that:
  - conflict with the conceptual definitions
  - are difficult to understand and apply
- Possible approach:
  - Use conceptual definition of a liability:
    - to show obligation to transfer economic resources
  - Use expanded statement of changes in equity:
    - to show wealth transfers between equity holders
Example: Changes in Equity

An entity has three classes of equity claim: existing shareholders of the parent, non-controlling interests (NCI) and holders of an option written by the entity. The holder paid CU5,000 for the option in 20X2. That amount was the fair value of the option at that date.

<table>
<thead>
<tr>
<th></th>
<th>Existing shareholders of parent</th>
<th>Non-controlling interests (NCI)</th>
<th>Obligation to issue shares</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>10,000</td>
<td></td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>20,000</td>
<td></td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td>Change in fair value of written option</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>31 December 20X2</td>
<td>10,000</td>
<td>24,500</td>
<td>4,200</td>
<td>42,700</td>
</tr>
</tbody>
</table>

On 31 December 20X2, the entity updates the measurement of the option to its fair value of CU4,000, recognising CU1,000 as a wealth transfer from option holders to existing shareholders of the parent.

Other elements

- Income → unchanged
- Expense → unchanged
- Other elements for other financial statements
  - Statement of cash flows (direct or indirect):
    - cash inflows
    - cash outflows
  - Statement of changes in equity
    - distributions of equity
    - contributions to equity
    - transfers between classes of equity
The objective of measurement is to faithfully represent relevant information about:

- the resources of the entity and claims against the entity, and changes to them
- how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s resources.

A single measurement basis will not provide the most relevant information.

Consider information produced in both the statement of financial position and the statement of comprehensive income.
Measurement (2)

Depends on: (see next slide)
- How an asset contributes to future cash flows (e.g., sell, rent)
- How the entity will fulfill or settle the liability

Number of different measurements used should be minimum necessary

Consider cost-benefit

Selecting a measurement method

- Relevant measurement method depends on:
  - The way in which an asset contributes to future cash flows
  - How an obligation will be fulfilled or settled

<table>
<thead>
<tr>
<th>Asset contributes to future cash flows</th>
<th>Fulfilling or settling an obligation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Using</td>
<td>Settling according to terms</td>
</tr>
<tr>
<td>Selling</td>
<td>Performing services</td>
</tr>
<tr>
<td>Holding for collection</td>
<td>Settling by negotiation</td>
</tr>
<tr>
<td>Charging others for right to use</td>
<td>Transferring</td>
</tr>
</tbody>
</table>
Selecting a measurement method (2)

- Cost
- Fair value and other current market prices
- Other cash-flow based measures

Cash-flow measures

- Possible factors to determine cash-flow measures:
  - Estimates of the amounts of cash flows
  - Timing of cash flows and time value of money
  - Uncertainties—possibilities of variations in the amount and timing of cash flows
  - The price for bearing the risk of variations in cash flows
  - Own credit
  - Other factors such as illiquidity (which may not be identifiable)
Cash-flow measures (2)

• Important questions about cash-flow measures:
  – Which factors should be considered?
  – Reflect the view of market participants or the reporting entity’s perspective?
  – Regularly remeasured (every reporting period) or remeasured only in response to triggering events?
  – When remeasurement occurs, which factors should be updated and which should be held constant?
Other issues in discussion paper

- Purpose and status → unchanged
  - Guide for the IASB
  - Is not an IFRS
- Presentation and disclosure → next slides
- Presentation of OCI → next slides

Presentation & disclosure: Problems

- Not currently addressed
- Presentation
  - How to present performance?
- Profit or loss
- Other comprehensive income (OCI)
  - Disclosures
    - May lead to poorly targeted disclosures
Presentation & disclosure

- Clarify purpose of primary financial statements & notes

- Introduce principles for presentation
  - Classification, aggregation & offsetting
  - Relationship between primary financial statements

- Introduce principles for disclosures
  - Materiality
  - Communication

Profit or loss & OCI

- Used in IFRSs but concerns about the absence of a principle for OCI

- Retain profit or loss as an important subtotal or total
  - IASB’s preliminary view
  - Two ways to retain profit or loss
    - Narrower use of OCI
    - Broader use of OCI

- Alternative approach
  - Single statement of comprehensive income
  - Not much support
### Topics in the Conceptual Framework

<table>
<thead>
<tr>
<th>Topics</th>
<th>In summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective of financial reporting</td>
<td>• Published 2010</td>
</tr>
<tr>
<td>Qualitative characteristics</td>
<td>• Published 2010</td>
</tr>
<tr>
<td>Reporting entity</td>
<td>• Will be developed from the ED 2010</td>
</tr>
<tr>
<td>Purpose &amp; status</td>
<td>• The Conceptual Framework will still be a guide for the IASB, not an IFRS</td>
</tr>
<tr>
<td></td>
<td>• May be useful for other stakeholders</td>
</tr>
<tr>
<td>Elements</td>
<td>• Assets/liabilities still describe real things (resources/obligations)</td>
</tr>
<tr>
<td></td>
<td>• Additional guidance for some problems</td>
</tr>
</tbody>
</table>

### Topics (2)

<table>
<thead>
<tr>
<th>Sections</th>
<th>In summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities/ equity</td>
<td>• Equity is still a residual</td>
</tr>
<tr>
<td></td>
<td>• Expand role of statement of changes in equity to show the effect of different classes of equity claims</td>
</tr>
<tr>
<td>Recognition</td>
<td>• Remove probability</td>
</tr>
<tr>
<td>Derecognition</td>
<td>• New section</td>
</tr>
<tr>
<td>Measurement</td>
<td>• New section</td>
</tr>
</tbody>
</table>
Topics (3)

<table>
<thead>
<tr>
<th>Sections</th>
<th>In summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presentation &amp; disclosure</td>
<td>• New section</td>
</tr>
<tr>
<td>OCI</td>
<td>• Retain profit/loss and OCI</td>
</tr>
<tr>
<td></td>
<td>• Define OCI</td>
</tr>
<tr>
<td>Other issues</td>
<td>• Going concern</td>
</tr>
<tr>
<td></td>
<td>• Business model</td>
</tr>
<tr>
<td></td>
<td>• Unit of account</td>
</tr>
</tbody>
</table>

More information

• Conceptual Framework website: http://go.ifrs.org/Conceptual-Framework

Questions