

## Report of the Due Process Oversight Committee (DPOC) meeting

Zurich, 3 February 2015

### 1. Update on technical activities

1.1 The DPOC received an update on technical activities.

#### *Due process issue*

1.2 The DPOC was informed that papers for the meetings of the IASB between September and December 2014 had been posted within the required deadline (a minimum of five working days in advance) with one exception, which concerned a matter that was identified during the balloting of *Disclosure Initiative* (Amendments to IAS 1). The paper was issued with a shortened posting period of three working days before it was discussed, which enabled the IASB to issue the amendments in December 2014.

#### *Major projects*

1.3 On **insurance contracts**, the DPOC was updated on the progress of the IASB's redeliberations on the issues raised in the comment letter responses, outreach and detailed fieldwork on the proposals in the IASB's revised Exposure Draft (ED), which had been issued in late June 2013. The DPOC was reminded that, while there was broad support for the proposals, there remained some significant areas of disagreement, in particular about performance reporting, and concerns about excessive complexity. During its redeliberations, the IASB had maintained extensive dialogue with all interested parties, including preparer bodies such as the European CFO Forum, and continued to consult its advisory bodies.

1.4 The IASB had made tentative decisions on the four targeted proposals in the ED that related to non-participating contracts (unlocking the contractual service margin, recognising the effects of changes in the discount rate in Other Comprehensive Income, insurance contracts revenue, and transition).

1.5 The DPOC was updated on the progress being made by the IASB on considering one of the most difficult and contentious issues in the 2013 ED, namely the accounting for contracts with participating features. It was noted that because many of the issues to be considered by the IASB in relation to contracts with participating features were interrelated, the staff had approached these deliberations by asking the IASB for indicative leanings, rather than tentative decisions. The staff noted that this process had helped the IASB and the staff to obtain feedback on the direction of the model, but it did have the consequence of extending the IASB's original timetable to allow it to consider issues in detail and to engage further with interested parties. As a result, the IASB did not expect to issue the Standard on Insurance Contracts before the end of 2015.

1.6 The DPOC raised the issue of the timing of the finalisation of the Standard on insurance contracts and the effective date of IFRS 9 *Financial Instruments*, as it was now clear that the effective date of IFRS 9 would precede that of the Standard on insurance contracts. The DPOC was informed that the IASB had discussed this matter in the January 2015 Board meeting and was looking to find a

solution that would permit companies to reassess their IFRS 9 business model decisions on implementation of the Standard on insurance contracts.

1.7 On **leases**, the DPOC was reminded that, at meetings between March 2014 and January 2015, the IASB and the US Financial Accounting Standards Board (FASB) had reached converged tentative decisions on almost all aspects of their joint project, the most important of which were as follows:

- (a) to require lessees to recognise assets and liabilities for all leases (other than short-term leases and, for the IASB, leases of small assets such as laptops and office furniture);
- (b) to measure lease liabilities on a present value basis, with simplifications made to that measurement to address concerns about cost and complexity;
- (c) to distinguish a lease from a service by assessing control (see further information in paragraphs 1.8 and 1.9); and
- (d) to, in essence, leave existing lessor accounting unchanged.

The two Boards, however, had reached different conclusions on the recognition and presentation of lease expenses in a lessee's income statement.

1.8 In the final quarter of 2014, the Boards had focused their discussions on the definition of a lease, which distinguished a lease from a service. Although respondents were generally supportive of the proposed definition in the ED, a number of key stakeholders, particularly in Europe and Japan, had raised concerns that the definition would inappropriately capture some contracts that they viewed as services. The Boards had considered various alternative approaches to defining a lease at their October and December 2014 joint meetings, but had concluded that these alternatives would have excluded substantive capital assets, such as oil rigs and ships, from an entity's balance sheet, so impairing the usefulness of the financial information.

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

1.10 The current expectation was that the two Boards would complete their redeliberations later in the first quarter of 2015.

1.11 On the **conceptual framework** project, the DPOC was informed that the IASB had completed its redeliberations of the Discussion Paper (DP) that had been issued in July 2013. At its October 2014 meeting, the IASB had confirmed that it was satisfied that sufficient due process steps had been undertaken and instructed the staff to begin the balloting process on an Exposure Draft (ED). It was anticipated that the ED would be published around the end of Quarter 1 of 2015. At its meeting in October 2014, the IASB had considered the comment period for the ED and agreed on a

comment period of 150 days, which was longer than the normal comment period of 120 days. The DPOC noted that the IASB had on its agenda a number of projects that could have implications for the *Conceptual Framework*, such as that on Financial Instruments with Characteristics of Equity (FICE).

1.12 On the project on **macro-hedging**, the DPOC was informed that the comment period on the DP *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging* had closed on 17 October 2014, with 126 comment letters having been received. In addition, over the last six months the staff, along with IASB members, had conducted over 50 outreach meetings with constituents across jurisdictions and with different types of constituents.

1.13 Although the IASB had received support from constituents for addressing the issue of accounting for dynamic risk management, there was significant divergence in views on the merits of the new approach between users and preparers in general. There was also a difference in views on what should be the overall objective of the project. The staff intended to bring a comment letter analysis to the IASB later in Quarter 1 of 2015, before asking the Board to consider the next steps on the project.

1.14 On the project on **rate-regulated activities**, the DPOC was informed that the comment period on the DP *Reporting the Financial Effects of Rate Regulation* had ended on 15 January 2015, with over 100 comment letters having been received. In addition, IASB members and staff had participated in a number of outreach events and sought input from the Accounting Standards Advisory Forum (ASAF). The IASB staff was aiming to provide a preliminary analysis of comments to the IASB at its meeting in February 2015 and would be seeking advice from the consultative group on Rate-Regulated Activities in March 2015, before asking the IASB to decide on the next steps for the project.

1.15 The DPOC was also updated on the progress of the **disclosure initiative** portfolio of projects that was being undertaken with the aim of improving the effectiveness of disclosures in financial reporting. The portfolio included both implementation and research projects. On the implementation projects, the DPOC was informed that, in December 2014, the IASB had issued narrowly-focused amendments of improvements to IAS 1 *Presentation of Financial Statements* and had also issued proposed amendments to IAS 7 *Statement of Cash Flows*. The main research project concerned *Principles of Disclosure*, which had the objective of improving disclosures in financial statements by identifying and developing a set of principles for disclosure in IFRS. The IASB was aiming to issue a DP in Quarter 2 of 2015.

#### *Research projects*

1.16 The DPOC was updated on the progress of a number of the research projects on the IASB's work plan. While there appeared to be a large number of items on the research programme, it was noted that not all of them would necessarily lead to projects on the IASB's Standard-setting agenda. The projects on the programme were classified into high-priority (of which there were eight), medium-priority (three projects) and longer-term (five projects). The forthcoming Agenda Consultation would influence the future composition of the research programme.

1.17 The DPOC was updated on the IASB's continuing efforts to building its research capability and its interactions with the broader research community.

#### *Post-Implementation Review (PIR)*

1.18 The DPOC received an update on the progress of the PIR of IFRS 3 *Business Combinations*, which had been launched in July 2013. The IASB expected to issue a Feedback Statement in Quarter 2 of 2015. The main issue that had been flagged up in the PIR concerned the accounting treatment for goodwill.

#### *IFRS Taxonomy*

1.19 The DPOC was updated on the progress of the IFRS Taxonomy due process trials, covering Taxonomy updates for both new or amended Standards and common practice elements. The trials were designed to give the IASB comfort as to its role in the approval of the content of the Taxonomy. Significant progress had been made on the first trial, where the IASB's December 2014 ED of amendments to IAS 7 (referred to in paragraph 1.14 above), including the draft Taxonomy Update as accompanying material. On the second trial, at the December 2014 Education session, IASB members had expressed concern that approval of a list of common practice elements at a public meeting might run the risk of these elements being perceived as authoritative guidance. To mitigate this risk, the trial would proceed on the basis that the process for common practice additions should be similar to that applied to educational materials, with a panel of at least three designated members of the IASB reviewing the proposed common practice taxonomy elements to affirm compliance with IFRS.

#### *Implementation and maintenance projects*

1.20 The DPOC took note of the progress of implementation and maintenance projects. The DPOC focused its discussion on the progress of the Transition Resource Group on Revenue Recognition (RTRG). Some 40 potential questions on the implementation of the new revenue recognition Standard had been raised so far, mostly by US stakeholders. For the majority of the questions considered, the RTRG's discussion had highlighted that stakeholders could understand and apply the Standard. A number of issues (for example, around licences and performance obligations) had highlighted a wider range of views and potentially greater challenges for some stakeholders in applying the Standard consistently. The IASB would have to consider what, if any, action it could or should take to assist entities in those areas, taking into account such factors as whether any change at all should be proposed, whether – if change was proposed - the IASB and the FASB should take the issue together or separately, and – if the FASB was proposing change - whether the IASB should do the same. In doing this the IASB would need to balance maintaining convergence with the FASB and the principle-based objective of IFRS 15. The IASB and the FASB were scheduled to have a joint discussion in February on a number of the issues raised and whether to propose any changes to the Standard in the pre-implementation period. It remained to be seen whether the two Boards remained converged on revenue recognition.

1.21 The DPOC questioned whether there were any due process implications around the work of the RTRG. The RTRG meetings were held in public and were webcast, with recordings available for stakeholders to listen to after the event. A summary of issues discussed at each meeting and next

steps was also prepared and made available on the website. The DPOC was reminded that the RTRG was a discussion group and not a decision-making one. Any potential implementation issues that arose would be referred to the IASB and the FASB.

### *General*

1.22 In summary, the DPOC confirmed that, in the case of all the major, research and implementation projects discussed, it was satisfied that all the due process requirements as set out in the *Due Process Handbook* were being met.

## **2. Comprehensive review of the *IFRS for SMEs*: due process 'lifecycle' review**

2.1 The DPOC received a report setting out a lifecycle review of the due process steps completed in the IASB's comprehensive review of the *IFRS for Small and Medium-sized Entities* (SMEs).

2.2 When the IASB first issued the *IFRS for SMEs* in 2009, it stated that it planned to undertake an initial comprehensive review of SMEs' experience in applying the Standard when two years of financial statements using the *IFRS for SMEs* had been published by a broad range of entities. Therefore, the initial comprehensive review commenced in 2012, with the issue of a Request for Information (Rfi), the objective of which was to seek public views on whether there is a need to make any amendments to the *IFRS for SMEs*.

2.3 In early 2013, the IASB's SME Implementation Group (SMEIG) met to discuss the public comments received on the RFI and develop a set of recommendations for the IASB on possible amendments to the *IFRS for SMEs*. The recommendations were published in March 2013 and were discussed by the IASB in subsequent meetings. Input was also sought from the IFRS Advisory Council.

2.4 The IASB issued an ED of proposed amendments to the *IFRS for SMEs* in October 2013, on which 57 comment letters were received, with most respondents supporting the majority of proposed changes. The SMEIG again considered the comments that had been received and developed a report on recommendations for the IASB to deliberate on. In summary, the IASB agreed on relatively minor amendments to the *IFRS for SMEs* arising from the review, with the main changes being:

- (a) allowing an option to use the revaluation model for property, plant and equipment – this was on the basis of feedback that not having such an option was a barrier to adoption in those jurisdictions where revaluation was common and/or required;
- (b) aligning the main recognition and measurement requirements for deferred income tax with IAS 12 *Income Taxes*. When the IFRS for SMEs was issued in 2009, the section 29 on accounting for tax was based on the proposals in an ED *Income Tax*, which had been issued in March 2009. However, the 2009 ED was never finalised by the IASB. Consequently, the IASB concluded that it was better to base the section on the existing Standard IAS 12;
- (c) aligning the main recognition and measurement requirements for exploration and evaluation assets with IFRS 6 *Exploration for and Evaluation of Mineral Resources*. The IASB

believed that the amendments were important to ensure that the requirements in the IFRS for SMEs were not more onerous than in full IFRS.

2.5 At its December 2014 meeting, the IASB had discussed due process steps on the project and, having confirmed that the amendments did not need to be re-exposed, the Board gave its permission for the balloting process to begin.

2.6 The DPOC was content to confirm that all necessary due process steps had been followed and that its review of due process on this project was now complete. The revised *IFRS for SMEs* was scheduled to be published later in the first half of 2015.

### **3. Reporting on projects**

3.1 The DPOC received a report setting out planned improvements that the IASB would employ to improve its public disclosure of the rationale used to reach its tentative decisions and conclusions. This followed a discussion at the DPOC meeting in October 2014, when the Committee had reviewed how the IASB had responded to feedback received on its 2013 ED *Leases*. This review had been prepared in response to concerns raised by some stakeholders that their views were not always given due weight. At that meeting, the DPOC stressed how important it was that the IASB did not leave itself exposed to claims that it had not followed due process and that it took steps to ensure that it disclosed publicly the rationale used to reach tentative decisions and conclusions, with special attention to issues that received substantial debate in the exposure process, including outside the comment letter consultation.

3.2 The IASB had committed to review the position and the report set out proposals in a number of areas:

- (a) working with National Standard-Setters (NSS) and regional bodies – recent experience had highlighted a lack of distinction between work that NSS and regional bodies undertook with the IASB and work that they undertook as part of their influencing activities. The IASB agreed that there should be clarity between these categories of work and planned to take steps to ensure that when NSS or regional bodies undertook work with the IASB, the terms of reference for that work and the expected outcomes were agreed in advance;
- (b) responding to comment letters and outreach events including correspondence outside the comment period – the IASB proposed to improve the transparency of how correspondence received outside a comment period was fed into the IASB's redeliberations of a due process document. The staff would, for major projects, make available on the website material outlining not only how the IASB had responded to feedback, but also providing the basis for the IASB's tentative decisions (such as in the project update on the leases project issued in August 2014); and
- (c) providing feedback to advisory bodies – the IASB proposed to improve the feedback to the IASB's main advisory bodies on how the advice that they provided was considered by the IASB. In future, the advisory bodies would be provided with an update of how the advice provided to the IASB at previous meetings was reported to the IASB, including a short summary of the actions taken by the IASB in response to the advice. When the advice was

not discussed at a public IASB meeting, the technical staff would identify why it was not reported and what actions were taken.

3.3 In discussion, the DPOC agreed with the proposals, noting the importance of such communications.

#### **4. Consultative groups and DPOC engagement**

4.1 The DPOC noted an update on the meetings of a number of the IASB's consultative groups since October 2014 and a forward schedule of group meetings. As at previous meetings, the Chair reminded the DPOC that it had a responsibility to monitor the effectiveness of the bodies and consultative groups that supported the IASB and again encouraged that a member of the DPOC (or the Director for Trustee Activities on behalf of the DPOC) should observe at least part of a face-to-face meeting of each of the major groups once a year and report back to the Committee to validate the breadth of attendance and an appreciation of the quality of dialogue. The DPOC should be proactive and have dialogues with the groups, which would also have the benefit of helping to address any potential problems with their operations. The DPOC asked that the staff prepare proposals for the Committee on which groups should be prioritised for observation and to alert the Committee if there were any meetings in the forward calendar which, in their view, would be of particular importance for a Committee member to observe.

#### **5. Correspondence**

5.1 At its meeting in October 2014, the DPOC considered a letter of 29 September 2014 that had been received from Hans van Damme, the Acting Chair of the then Supervisory Board of the European Financial Reporting Advisory Board (EFRAG). The letter proposed that a public 'fatal flaw' review prior to finalising a new Standard or major amendment should be included as a formal step in the IASB's due process. At present, the *Due Process Handbook* included as an option making public a draft for editorial review. The suggestion repeated a comment made by EFRAG in its response in 2012 to the review of the *Due Process Handbook*. At that meeting, the staff and the IASB undertook to review the suggestion and to revert to the DPOC with advice as to whether events of the past few months had altered the current stance that such publication should be optional.

5.2 At this meeting, the DPOC considered the advice received from the staff and the IASB, who agreed that appropriate quality control was necessary to facilitate and reduce the cost of implementation of new requirements and to support consistent application of IFRS. The IASB had identified a number of internal improvements that could be made, which were designed to ensure that some specific procedures that were required in completing a final Standard or amendment to a Standard had been carried out and that the procedures were evidenced. One such improvement was to improve the quality of pre-ballot drafts, including – where appropriate – 'cold reviews' of such drafts by senior members of the technical staff.

5.3 The staff had also discussed EFRAG's concerns with a number of the external parties that participated currently in the limited circulation editorial reviews that took place. Those participants had agreed to provide increased support to the editorial review, including performing a second review if significant changes had been made following the first review.

5.4 In addition to these improvements, the DPOC was informed that an arrangement had been put in place to further enhance the external review process for pre-ballot drafts, including an independent external review by a former standard-setter of all such drafts.

5.5 Following discussion, the DPOC considered that the improvements identified by the IASB and the enhancements to the external review process would help to improve the quality control procedures for final amendments and Standards. As a consequence, the DPOC took the view that it was better to retain the current flexibility provided in the *Due Process Handbook* rather than require a mandatory public 'fatal flaw' editorial review.

5.6 The DPOC agreed that the Chair should send a response to EFRAG making these points.

5.7 Other than this, no new correspondence had been received since the October 2014 meeting.

END