

Report of the Due Process Oversight Committee (DPOC) meeting

Mexico City, 8 October 2014

1. Update on technical activities

1.1 The DPOC received an update on technical activities.

Major projects

1.2 In terms of publications issued since the DPOC's meeting in July 2014, the Committee noted that the most significant was that of the final version of **IFRS 9 Financial Instruments**, which had been published in July 2014.

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, as at June 2014, the IASB had made tentative decisions on three of the five targeted proposals in the ED as they related to non-participating contracts (unlocking the contractual service margin, recognising the effects of changes in the discount rate in Other Comprehensive Income, and insurance contracts revenue).

1.4 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 were continuing to obtain feedback on the direction of the model.

1.5 The staff planned to begin discussions on transition, the fifth of the targeted areas in the ED, in October 2014.

1.6 The DPOC noted that, while there was broad support for the proposals, there remained some significant areas of concern, in particular around complexity and accounting mismatches. The IASB had received many conflicting views from the industry, given the range of different business models in place, and was still seeking to achieve a balance between completing the project and the need to maintain the quality of its decision-making process in dealing with such a challenging issue. The IASB was continuing its dialogue with interested parties. The IASB had, for example, sought advice from the Accounting Standards Advisory Forum (ASAF) at each of its meetings in 2014, most recently in September, and was holding meetings with industry representatives from different regions. The IASB was seeking to meet various concerns that had been expressed about the proposals, but acknowledged that this was making the proposed Standard more complex. The Board would, at some stage, need to step back and consider the cumulative impact of all the tentative decisions it had made and would make. The IASB was continuing to maintain extensive dialogue with all parties and to consult its advisory bodies. The deliberations would most probably continue into the New Year. The IASB still planned to issue a Standard on insurance contracts in 2015.

1.7 The DPOC questioned the IASB representatives on the diverse views of constituents on the proposals and how the concerns were being considered and reported on by the Board. From a due process perspective, the IASB was mindful of the need to ensure that it had given constituents sufficient opportunity for their views to be expressed and for the public disclosure of the rationale used by the Board to reach tentative decisions (taking into account the concerns that had been expressed in relation to the leases project, as outlined in section 2 below). The DPOC's attention was drawn to the project webpage on the IASB's website that provided up-to-date feedback on the progress of the project.

1.8 The DPOC noted that the comprehensive review of the **IFRS for Small and Medium-sized Entities (SMEs)** was continuing, and that the IASB at its October 2014 meeting was scheduled to start discussing the issues raised in the responses to the ED on the review that had been issued in October 2013. The DPOC was informed that a draft report containing the recommendations of the Small and Medium-sized Entities (SMEIG) on the proposals in the ED had been prepared and was awaiting final approval by the SMEIG.

1.9 The DPOC had a brief discussion on convergence and what had been achieved, noting that the most notable success had been the issue in May 2015 of the converged Standard on **revenue recognition**. The DPOC noted that the IASB and the US Financial Accounting Standards Board (FASB) had established a Joint Transition Resource Group (TRG) for revenue recognition and the group had held its first meeting on 18 July and would hold its second meeting at the end of October.

1.10 On the **conceptual framework** project, the DPOC was informed that the IASB was pressing ahead with an ambitious timetable, although there had some slight slippage in the timetable to allow for additional input to the process of drafting an ED, which was now scheduled to be published in early 2015 rather than by the end of 2014, as previously anticipated. Some of the more substantive recent discussions by the IASB had focussed on what the *Conceptual Framework* should say about measurement, and the distinction between profit and loss and Other Comprehensive Income (OCI). The DPOC also noted that, at its September 2014 meeting, the IASB had discussed whether the *Conceptual Framework* would provide the IASB with sufficient and appropriate tools to enable it to consider: (a) the time horizon for investment by a reporting entity; and (b) whether long-term investors in a reporting entity needed different information from short-term investors. These issues had also been discussed with the ASAF at its September 2014 meeting.

1.11 The DPOC noted that the IASB had tentatively decided, among other things, that the proposed references in the revised *Conceptual Framework* on business activities, measurement and the distinction between profit and loss and OCI provide sufficient tools for the IASB to make appropriate standard-setting decisions if future projects considered: (a) how to measure the long-term investments (or liabilities) of entities whose business activities included long-term investments; and (b) whether such entities should present changes in the carrying amount of those investments (or liabilities) in profit or loss or in OCI. The IASB also tentatively decided that the *Conceptual Framework* contained sufficient and appropriate discussion of primary users and their information needs, and the objective of general purpose financial reporting to address appropriately the needs of long-term investors. Given the importance of these issues to some stakeholders, the DPOC advised that the rationale for this view should be set out clearly in the Basis of Conclusions in the forthcoming ED.

1.12 The DPOC was updated on the progress of the projects on **macro-hedging**, where the comment period on the DP was scheduled to close on 17 October, the **disclosure initiative** and the project on **rate-regulated activities**, where a DP had been published on 17 September.

Research projects

1.13 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 of them would necessarily lead to projects on the IASB's Standard-setting agenda. The programme reflected what had emerged from the Agenda Consultation conducted in 2011-12. It was noted that a Request for Information (Rfi) on the next Agenda Consultation would be issued during 2015. The projects on the programme were classified into high-priority, medium-priority and longer-term, but the IASB recognised that it needed to consider more the prioritisation and resource allocation. Taking note of these comments, the DPOC welcomed the purpose of the programme by analysing at an early stage possible financial reporting problems and potential ways to remedy them, which would help the IASB in determining whether they should be added to its agenda.

1.14 The DPOC questioned whether the IASB was undertaking all the work itself on the programme, given the resource constraints. It was noted that the IASB was reaching out to the global standard-setting community and to academics, with work on some projects being taken forward by others. As part of this, the DPOC was informed of the work being done to build the IASB's research capability and interactions with the broader research community, including – earlier in October – the hosting of a successful Research Forum at the Saïd Business School, University of Oxford.

IFRS Taxonomy

1.15 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. The scheduled timetable for the completion of the trials had slipped from the end of 2014 to the end of the first quarter of 2015, to allow more time to run the trials and assess the costs and benefits of the proposals. The DPOC expressed some concerns with this slippage. The IASB agreed to ensure that the due process trials, which were designed to give the IASB comfort as to its role in the approval of the content of the Taxonomy, should be regarded as a priority. This was in line with the DPOC's view that the trial run process should be completed as soon as possible.

Implementation and maintenance projects

1.16 The DPOC took note of the progress of implementation and maintenance projects.

General

1.17 In response to a request from the Committee, the technical staff agreed to review and, as necessary, improve the completeness of the Project Work Plan report to the Committee, in order to provide a more complete snapshot of anticipated project time lines.

2. Leases projects

2.1 At this meeting, the DPOC paid particular attention to the progress on the leases project, in particular considering the concerns raised by some stakeholders and the comments about the project that had been referred to by the Chair of the UK Financial Reporting Council (FRC) in his presentation to the Trustees at their July 2014 meeting. The FRC had raised concerns that stakeholder views were not always given due weight. While the FRC acknowledged that the IASB had taken steps to improve communication with stakeholders, it also suggested that stakeholders needed a better understanding of why their views and suggestions were not taken up by the IASB.

2.2 The IASB noted that it had taken a careful and measured approach in considering and evaluating the feedback that had been received on the May 2013 ED that had been issued jointly with the FASB. Throughout the redeliberations, the project team had continued to consult the IASB's main advisory bodies: the ASAF, the Capital Markets Advisory Committee (CMAC), the Global Preparers Forum (GPF), and the Advisory Council.

2.3 The DPOC noted that discussions were continuing on the leases project and highlighted the importance of the fact that the two Boards were united on the most important aspect of the project, namely the balance sheet approach for lessees. However, the Boards had come to different conclusions on the recognition and presentation of lease expenses in a lessee's income statement, as follows:

- a. the IASB had decided tentatively upon a single lessee model, whereby a lessee would recognise interest on lease liabilities separately from amortisation of lease assets; and
- b. the FASB had decided tentatively upon a dual lessee model that would retain the existing distinction between operating and finance leases, which would essentially result in no change to the lessee's income statement compared with the income statement under existing requirements.

2.4 On a portfolio basis, the DPOC noted that the difference in effect in the income statement would not be significant. The IASB representatives acknowledged that in practical terms the difference would be small, but conceptually the gap would be bigger. There was a risk that, under the dual lessee model, some constituents might question why lease assets and liabilities should be recognised on the balance sheet. The lack of full convergence with the FASB had increased the pressure on the IASB in recent months, with a number of stakeholders focussing on the differences between the Boards and seeking to exploit them.

2.5 The DPOC was updated on the outcome of the additional public consultation on leases that had been launched at the end of June 2014 by the European Financial Reporting Advisory Group (EFRAG) and the four major European national standard-setters, which included seeking constituents' views and their preference on the two alternative income statement approaches proposed by the IASB and the FASB. It was clear from the feedback that most investors and the majority of preparers who expressed a preference preferred the IASB's single lessee model.

2.6 The EFRAG consultation had also sought views on the definition of a lease and, in particular, which transactions should qualify as leases and which should be excluded from the scope and be treated as in-substance service transactions. This issue had been discussed by the ASAF at its September 2014 meeting, on the basis of an EFRAG Staff Paper (which had not been reviewed or

approved by EFRAG's Technical Experts Group, TEG) and which proposed a definition of what constituted a lease that was expected to be even more limited than that in the current lease standard, IAS 17. There was little support at ASAF for such a proposal.

2.7 In terms of handling the concerns raised by the FRC in particular, the technical staff referred to the comprehensive documentation on the leases project page on the website, including a *Project Update* that had been issued in August 2014 which set out the rationale for the main tentative decisions that the Board had taken, including on its preference for the single lessee model for the income statement. IASB members and the technical staff had also met with the FRC to discuss the issues it had raised, notably around the definition of a lease, but acknowledged that they had not 'closed the loop' with the FRC concerns by reflecting them in a paper for the Board to discuss at one of its public monthly meetings. It was noted that the FRC concerns would be considered in a paper on the lease definition that was being taken to the IASB at its October meeting.

2.8 The technical staff's view was that the due process requirements had been fully adhered to and had been applied in an appropriate manner for such an important and controversial project. As noted above, the IASB was taking a careful and considered approach in its redeliberations and was continuing to engage with its advisory bodies and stakeholders, which had generated some further submissions to the Board outside of the formal comment letter process. That said, it was acknowledged that there was scope to improve communications by making additional efforts to communicate the basis for the IASB's tentative decisions in a publicly accessible way and to ensure that there was an understanding of the basis for such decisions. The IASB noted that it hoped that the *Project Update* would prove useful in that regard.

2.9 The DPOC acknowledged the extensive extent of the outreach and the level of communication that the IASB and technical staff had undertaken. The Committee also acknowledged that, on such a high-profile and controversial issue, some stakeholders might use due process as an excuse for the fact that they simply did not agree with some or all of the technical decisions taken by the IASB. That said, it was important that the IASB did not leave itself exposed to such claims and 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. It was clear that the IASB could not respond to each individual comment letter or submission received, especially on projects such as leases that generated a very high level of response, but it was important that there was communication from the IASB summarising the major issues raised with the Board and the rationale for the Board's tentative decisions, in particular where it took a different view on the issues raised to stakeholders. This should be done throughout the life of a project.

2.10 In the light of this discussion, the IASB committed to review its public disclosure of the rationale used to reach tentative decisions and conclusions, with special attention to issues that received substantial debate in the exposure process. The DPOC requested that the technical staff demonstrate that the IASB had publicly disclosed the rationale for its actions in relevant public documents throughout the entire life of a project, from discussion paper to final issuance of a new or revised IFRS or Interpretation.

2.11 Finally, the DPOC noted that the IASB representatives confirmed that the two Boards would continue their redeliberations on a joint basis, with the intention of minimising any differences between IFRS and US GAAP.

General

2.12 In summary, having discussed the leases projects as above, 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.

3. Effects Analysis Consultative Group

3.1 The DPOC reviewed and was content with the near-final draft of the report of the Effects Analysis Consultative Group (EACG). At present, it appeared that all the proposals in the report fell within the existing framework of the *Due Process Handbook*, but the DPOC would consider any changes if they were thought to be necessary. The Committee was appreciative of the considerable work of the EACG, which would disband upon publishing its report.

3.2 The DPOC was content that the Trustees should welcome the final version of the report and commend it to the IASB to implement the conclusions and recommendations to the extent that they had not already been implemented. The DPOC also agreed that it was important that the report was finalised and published as soon as possible, so that the proposals could be embedded into the IASB's process as quickly as possible, to the extent that they were not already reflected in the due process.

3.3 The DPOC considered and was content with the staff's proposals for the follow-up to the report and the need to ensure that it was implemented in a sensible and meaningful way and which fulfilled the desire of the EACG for the report to be of practical help to the IASB.

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 July 2014 and a forward schedule of group meetings. As at previous meetings, the Chairman 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. He invited DPOC members to submit attendance suggestions by e-mail.

5. Correspondence

5.1 The DPOC considered a letter of 29 September 2014 that had been received from the Hans van Damme, the Acting Chair of the Supervisory Board of 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*. 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. Other than this, no new matters had been received since the July 2014 meeting.

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