Report of the Due Process Oversight Committee (DPOC) meeting

Milan, 28 January 2014

1. Update on technical activities

1.1 The DPOC received an update on technical activities.

Major projects

1.2 The DPOC noted that the amendments to International Financial Reporting Standard (IFRS) 9 dealing with **financial instruments: hedge accounting** had been completed and published in November 2013.

1.3 The DPOC was updated on the progress of the major projects on the IASB's work plan. On **financial instruments: classification and measurement**, the DPOC was reminded that the main changes proposed in the November 2012 Exposure Draft (ED) were to clarify the notion of principal and interest, to introduce a fair value through Other Comprehensive Income (OCI) category for simple debt investments (ie those where the contractual cash flows were 'solely payments of principal and interest', SPPI), and to propose the clarification to the concept of 'holding to collect' contractual cash flows. Joint deliberations by the IASB and the US Financial Accounting Standards Board (FASB) had started in September 2013 (the FASB having issued its own ED in February 2013). While it was hoped the outcome would bring the requirements in IFRSs and US GAAP closer together, the DPOC was informed that the FASB, at its December 2013 meeting, had made a number of tentative decisions that suggested it would not proceed fully with the proposals set out in its ED regarding the SPPI. The DPOC questioned the IASB representatives at the meeting about the implications of the IASB and the FASB coming to different decisions. It was acknowledged that the situation was unfortunate. The DPOC was informed that, at its February 2014 meeting, the IASB would consider the position taken by the FASB, at the same time as it reviewed the due process steps undertaken on the project. After the IASB's discussion in February, the next step for the DPOC would be to undertake a 'lifecycle' review of the project at its April 2014 meeting.

1.4 On **financial instruments: impairment,** the DPOC was reminded that this was one of the most critical and difficult parts of the IASB's project to overhaul the accounting for financial instruments. The IASB's ED *Financial Instruments: Expected Credit Losses* had been well received, with support expressed by users of financial statements, preparers and audit firms. The DPOC was reminded that the prospect of convergence with the US, however, was unlikely. The FASB, at its meeting in December 2013, had elected to proceed with its model under which lifetime expected credit losses were recognised on all financial instruments at initial recognition and measured thereafter on this basis. The DPOC asked what were the differences between the IASB and FASB models and whether they were simply related to an issue of the timing of the trigger to recognise losses. Although it was noted that the timing of the recognition of expected losses would be different, there were additional, more detailed aspects that would lead to further differences. The DPOC sought clarification on the views of the Financial Stability Board (FSB) in particular, given that the FSB had been calling for a converged solution, and whether there was a reputational risk to the IASB. The DPOC was reminded that the IASB was a member of the FSB and that the situation with regard to impairment had been discussed at FSB meetings at the end of 2013. The FSB now accepted that there would not be convergence on impairment, but wanted to see the impairment proposals in place as soon as possible. The IASB had agreed to hold a session with some FSB members that were regulators to see what disclosure requirements they might impose for regulatory purposes. Again, it was noted that the situation was unfortunate. As with classification and measurement, the DPOC was informed that, at its February 2014 meeting, the IASB would consider the position taken by the FASB, at the same time as it reviewed the due process steps undertaken on the project. From a due process perspective, the IASB was confident that it had taken all necessary steps and had sufficient information and feedback to move forward. The next step for the DPOC would be to undertake a 'lifecycle' review of the project at its April 2014 meeting.

1.5 On **accounting for macro hedging,** the DPOC was informed that the IASB would shortly publish a Discussion Paper (DP), with a 180-day comment period, which was longer than the minimum 120-day period, given the very technical and complex nature of the issue.

1.6 With regard to the other major projects, the DPOC noted that the second ED on **leases** had generated 640 comment letters. During the comment period extensive outreach activities had been undertaken focussing in particular on obtaining feedback from users of financial statements (with meetings involving over 220 investors and analysts), which had revealed support from the majority of users for the proposal to recognise lease assets and liabilities on the balance sheet. A summary of the comment letters and outreach activities had been presented to the IASB and FASB at their joint meeting in November 2013. The summary revealed that, while there was praise for the boards' efforts to respond to concerns regarding the 2010 ED, there remained considerable concern about the cost and complexity of the proposals in the second ED issued in 2013. The boards had started their redeliberations in January 2014, considering the issues raised with regard to the lessor model, the lessee model and any possible scope implications, with the aim of reaching decisions on these important issues in March 2014. The DPOC was informed that, prior to making decisions at the joint board meeting in March, the Accounting Standards Advisory Forum (ASAF) would discuss the relevant papers at its March meeting. The DPOC asked whether the IASB and the FASB proposals would remain converged. The IASB representatives noted that the position would be clearer following the discussions at the March 2014 joint meeting, but that the risk of divergence could not be ruled out. It was noted that there remained considerable resistance to the proposals, which were the subject of intense pressure, in particular in the USA, but also in Europe as well. The timing of progress depended heavily on the outcome of the March 2014 joint meeting. If the decisions at that meeting were clear, then redeliberations could be substantively completed by summer 2014, with an IFRS being issued in early 2015.

1.7 On **revenue recognition**, the DPOC was informed that the proposed new Standard was in the process of being balloted and was expected to be issued in the first half of 2014. The IASB and FASB were now giving some thought to the establishment of the limited-life Revenue Implementation Group that was designed to support preparers in the transition to the new Standard. The DPOC had previously discussed and supported the establishment of such a group, but noted a caution that it should not provide authoritative guidance. The membership of the Implementation Group had still to be decided, but was proving to be a challenge and the process would need to be handled carefully. The intention was that the group would consist primarily of auditors and preparers who were experts in revenue recognition issues. The IASB noted that the proposed composition of the group would be brought to the DPOC for its review before being announced.

1.8 On **insurance contracts**, the IASB had issued a revised ED in late June 2013 and the comment period ended on 25 October 2013. A total of 194 comment letters had been received. The IASB had also undertaken extensive outreach and detailed fieldwork. Summaries of the main issues raised had been presented to the IASB at its January 2014 meeting (the summary of the user outreach had been circulated to the DPOC as part of the papers for this meeting, and the DPOC was informed that a separate summary of the fieldwork undertaken had also been presented to the IASB). The DPOC was told that while there was broad support for the proposals, there remain some significant areas of concern, in particular around complexity and accounting mismatches. It was also noted that the IASB had also received summaries of the comment letters and outreach regarding the FASB's ED on insurance contracts that had been issued in June 2013. The two boards planned to hold a discussion on insurance contracts at their joint meeting in March 2014.

1.9 On the **conceptual framework** project, the DPOC was informed that the IASB had received over 200 comments to the DP that had been issued in July 2013. The IASB had also carried out extensive outreach, including holding a number of public roundtables, and had consulted its advisory groups, in particular the ASAF, which was acting as the consultative group on the conceptual framework project.

1.10 In the case of all the major projects discussed, the DPOC was satisfied that all the due process requirements as set out in the *Due Process Handbook* were being met.

Implementation and maintenance projects

1.11 The DPOC was updated on the progress of a number of the implementation and maintenance projects on the IASB's work plan. On **IAS 1 - disclosure initiative** the DPOC was informed that the IASB was working on a number of proposed amendments to the Standard. The IASB planned to issue an ED on this and other amendments to IAS 1 arising from the follow-up to the IASB's Disclosure Forum in the first quarter of 2014. On the application of materiality, the IASB was working with the International Organisation of Securities Commissions (IOSCO) and the International Auditing and Assurance Board (IAASB).

1.12 The DPOC was informed that the project on **IAS 41 - bearer plants** was progressing. At its January 2014 meeting, the IASB had considered a summary of the comment letters received in response to the June 2013 ED. Some of the main concerns raised by respondents included extending the scope of the amendment to include livestock, exempting produce growing on bearer plants from fair value measurement and providing further guidance on determining when a bearer plant reached maturity. Given such comments, the IASB would consider making IAS 41 a candidate for a Post-Implementation Review (PIR).

1.13 The DPOC was informed that the IASB would shortly issue an ED of a proposed amendment to **IFRS 11** – **acquisition of an interest in a joint operation**, having reviewed the due process steps and concluding that the applicable due process had been followed. There was a more general issue with IFRS 11, which was generating a number of requests for additional guidance. The IASB was now getting feedback that the IASB should let practice evolve first, rather than seek to make early amendments to the Standard.

1.14 There were a number of proposals in the pipeline to amend **IAS 28**. The IASB was seeking to batch them into one ED. Given the number of referrals the IASB was receiving on IAS 28, the IASB would be considering whether there needed to be a more fundamental look at IAS 28 as part of the research programme.

1.15 The DPOC was informed that the IASB was about to issue (on 30 January) a Request for Information (RfI) on the **Post-Implementation Review (PIR) of IFRS 3 *Business Combinations.*** A schedule of the due process steps undertaken to date had been submitted to the DPOC, together with a summary of the extent of the consultation that the IASB had undertaken in developing the RfI, including with the ASAF. The IFRS 3 PIR would be a larger review than that conducted for IFRS 8.

1.16 The DPOC queried the decision by the Interpretations Committee not to add to its agenda a request to for clarification to **IAS 19 – actuarial assumptions: discount rate.** The IASB representatives noted that the issue of discount rates was a cross-cutting one and that a broader project on the issue had been added to the research programme.

2. Forthcoming IFRS *Regulatory Deferral Accounts*: due process 'lifecycle' review

2.1 The DPOC received a report summarising the lifecycle of the due process to date on the project to develop an interim IFRS on the issue of rate-regulated activities. The forthcoming Standard would permit first-time adopters of IFRS to continue to apply their existing accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances when making the transition to IFRS.

2.2 The IASB's rate-regulated activities project had begun with the publication of an ED in July 2009. The responses to that ED, and other outreach activities undertaken at the time, raised many technical issues that the IASB could not decide how to resolve. This, together with staff resource constraints and the fact that the IASB was divided on how to progress the issue, led the IASB to decide to suspend the project in September 2010 and await the outcome of the IASB's public consultation on its future agenda. In the light of the views received in the *Agenda Consultation* in 2011, the IASB decided in September 2012 to restart the project with a research phase, with the aim of developing a DP.

2.3 Following further deliberations, including consulting the IFRS Advisory Council, the IASB – in December 2012 – decided to develop an ED for an interim solution that proposed to permit first-time adopters of IFRS that recognised regulatory deferral account balances in accordance with their previous GAAP to continue with their existing accounting policies for such balances when making the transition to IFRS. This should lower a significant barrier to the adoption of IFRS for these entities because it would allow them to adopt IFRS without having to make a major change to their accounting policies for rate-regulated activities that might be followed by another major change once the comprehensive project was completed. The ED was published in April 2013, with a 132-day comment period.

2.4 The IASB received 114 comment letters in response to the ED. The responses revealed mixed support for the proposed interim solution, with a slight majority in favour, and a further proportion (around 20 per cent of the total responses) wanting the application to be available for a wider range of entities. Just over a quarter of respondents disagreed with the proposal to issue an interim IFRS, generally agreeing with the alternative views of the three IASB members that dissented to the publication of the ED, who were of the opinion that: (a) the proposal would reduce comparability and lead to inconsistency with existing IFRS practice; (b) create uncertainty for potential future adopters of IFRS; and (c) for two of the members result in the recognition of regulatory deferral balances that did not meet the definitions of assets and liabilities in the IASB's *Conceptual Framework for Financial Reporting*.

2.5 Following redeliberations of the proposals at its meetings in September and October 2013, the IASB decided to finalise, subject to some clarifications and additional application guidance, an interim IFRS that was limited to first-time adopters of IFRS. The IASB took the view that the restriction on the scope of the interim IFRS, together with the presentation and disclosure requirements, balanced the needs of preparers and users in jurisdictions that recognised regulatory deferral account balances in accordance with previous GAAP, and those that already prepared IFRS financial statements and did not recognise such balances. At its November 2013 meeting, the IASB also reviewed a staff paper on the due process undertaken on the project and stated that it was satisfied that all of the necessary due process steps required to date had been completed and that a draft of the interim IFRS could be prepared for balloting. A copy of that paper had been circulated to the DPOC on 11 November 2013 and was presented again to the DPOC at this meeting.

2.6 The DPOC noted that the same three IASB members who had provided alternative views on the ED were dissenting from the issue of the interim IFRS and that the Standard was not supported by all stakeholders. The DPOC reviewed the proposed effects analysis to be issued with the Standard, noting that the draft that had been issued with the ED had generated a specific comment from only one respondent, although that respondent had made the effects analysis the major theme of its comment letter in support of the proposals.

2.7 The DPOC challenged the IASB's decision to press ahead with the issue of the interim IFRS, seeking additional clarifications and assurance on a number of matters, including:

- whether the interim IFRS would result in less comparability – given the fact that the provisions of the interim Standard would be available for first-time adopters, but not those jurisdictions and companies that had already adopted IFRS. The IASB representatives noted that the IASB had considered this issue and addressed it in the Basis for Conclusions accompanying the interim Standard. The interim Standard required that regulatory deferral account balances, and the movements in those balances, be isolated and shown as separate line items in the financial statements. This would increase transparency of these items and provide greater comparability across those entities within the scope of the Standard. The increased transparency would also allow direct comparisons against entities that did not recognise these balances. In addition, if the interim IFRS provided an incentive for further jurisdictions yet to adopt IFRS to do so, that would also help to improve comparability overall;
- whether the interim IFRS raised an issue of fairness in being restricted to first-time adopters – the IASB representatives acknowledged that the adoption of IFRS had been challenging for those jurisdictions that had, under their previous GAAP, allowed for the recognition of

regulatory deferral balances and the movements in those balances. However, widening the scope of the interim IFRS would also create challenges. The IASB was also clear that the interim IFRS did not create a precedent for the recognition of regulatory deferral account balances as assets and liabilities. The IASB had not come to any view on that, which was the objective of the rate-regulated activities research project. If the IASB ultimately came to the view that they were not, this could force companies to have to write them off again;

- the level of resistance that the proposals had received, from three Board members, a significant minority of respondents and a majority of the IFRS Advisory Council – the IASB representatives noted that the IASB had taken its decisions on the interim IFRS in the full knowledge of the level of concern that had been expressed. However, the consultations undertaken were not voting exercises. Ultimately, the IASB had to use its own judgement and reach a decision, satisfying itself that it had carried out all necessary due process and concluding that the new Standard would improve financial reporting;
- the length of time the interim IFRS would remain in force, in particular if the main project on rate-regulated activities took a long time to complete - it was also noted that, while a majority of the IFRS Advisory Council did not support an interim solution, they had supported the wider project and concluded that, if an interim IFRS was developed, it should be done quickly so as not to jeopardise the timetable for any comprehensive solution to be developed.

2.8 In discussion, the DPOC acknowledged the IASB's rationale for reaching the decisions it had on the interim IFRS. The DPOC hoped that such situations would be rare and temporary. The IASB representatives noted that one of the objectives of introducing the research programme following the *Agenda Consultation* in 2011 was to identify issues and problems much earlier in the process, which should address such situations in future.

2.9 The DPOC discussed the issue of the length of time the interim IFRS might be effective and the need for the IASB to finalise the main project as quickly as possible. A number of possibilities were discussed, such as the inclusion of a 'sunset clause' in the interim Standard. While this was thought to be impracticable, the DPOC emphasised to the IASB the importance of completing the comprehensive project as quickly as possible. The IASB representatives committed to come back to the DPOC with specific objectives on project timing for the rate regulated activities project. With these assurances, in conclusion, the DPOC considered that all the due process steps had been followed satisfactorily and that the IASB could proceed with the issue of the interim IFRS.

3. IFRS Taxonomy (XBRL)

3.1 The DPOC considered a progress report on the IASB's previously approved plan to restructure staffing and consultative activities related to electronic reporting**,** covering two main issues:

- the proposed changes to the due process for updating the IFRS Taxonomy; and
- proposals to replace the XBRL Advisory Council (XAC) and XBRL Quality Review Team (XQRT) with a single consultative group, the IFRS Taxonomy Consultative Group.

3.2 On due process changes, the DPOC approved the staff recommendations that:

a. proposed interim IFRS Taxonomy releases should be the primary document for public consultation;

b. the annual IFRS Taxonomy would be a physical compilation of previous interim releases and would not be issued for public consultation; and

c. the proposed change would effective immediately ie would be applied to the 2014 annual IFRS Taxonomy (to be issued in February 2014) and all subsequent IFRS taxonomy releases.

3.3 On consultative arrangements, the DPOC approved the staff recommendations regarding:

a. the establishment of a new consultative group called the IFRS Taxonomy Consultative Group;

b. the terms of reference and operating procedures of this new group;

c. the temporary extension of the terms of the XQRT members until the new IFRS Taxonomy Consultative Group was operational. The DPOC noted that the terms of XQRT members had all expired on 31 December 2013, but that the IASB had continued to consult with those members, as well as undertaking targeted outreach, in particular with regulators; and

d. the option for XQRT and XAC members to apply for membership of the IFRS Taxonomy consultative group.

3.6 The DPOC also noted the IASB's efforts to increase the engagement and involvement of investors and regulators in the process.

4. Consultative groups and DPOC engagement

Update

4.1 The DPOC considered an update on a number of consultative groups following the annual review that had been considered by the Committee at its July 2013 meeting:

- **Accounting Standards Advisory Forum (ASAF)** – this group remained very active, not least given its role as the consultative group on the conceptual framework project. The third full meeting of the group had taken place on 5-6 December, with a full-day scheduled on the conceptual framework. The DPOC noted that Michelle Sansom had now taken up her post as ASAF Co-ordinator;
- **Capital Markets Advisory Committee (CMAC)** – the DPOC was provided with an update on the revised membership for CMAC from the beginning of 2014 and the continuing efforts by the staff and the Committee to broaden its membership in terms of both professional background and geographical representation;
- **Project-specific consultative groups (financial instruments, leases and insurance)** – the DPOC was provided with an update on the staff's latest assessment of these groups, given that none of them had held formal meetings for some time. The DPOC considered and was content with the staff's view in support of the continued existence of the three groups, as lists of experts that the IASB could call on to get specific advice on specific elements of each proposed standard. As agreed at previous meetings, the IASB agreed to promptly come back with proposals to disband any groups that had outlived their original purpose;

- **Shariah-compliant Instruments and Transactions** – the DPOC was provided with an update on the progress of this group and noted the expanded the membership of this group, in line with the proposals that were considered by the DPOC at its October 2013 meeting.

SME Implementation Group (SMEIG)

4.2 The DPOC was updated on the progress of the IASB's proposal to increase the size of the SMEIG to 30 members as from July 2014, noting that a call for applications had been issued on 14 January 2014. The DPOC noted that, after receipt and consideration of the applications, the technical staff would bring the proposed membership of the SMEIG to the DPOC for review to ensure that there is a satisfactory balance of perspectives, including geographical balance.

4.3 At this meeting, the DPOC considered and approved proposals to amend the SMEIG's *Terms of Reference and Operating Procedures for the SME Implementation Group* (Terms of Reference) to reflect the decision made by the IASB at its April 2013 meeting to amend the SMEIG's Question and Answer (Q&A) programme. The proposed Terms of Reference made clear that Q&As represented non-mandatory guidance, which would be subject to the normal due process for educational material. The staff were conscious of the need to have a clear distinction between non-mandatory and authoritative guidance. In rare cases where the SMEIG might identify an issue that required mandatory guidance, this would be subject to the same due process steps as for proposed and final amendments to the *IFRS for Small and Medium-sized Entities.*

DPOC engagement

4.4 On engagement, the DPOC noted that DPOC member Sheila Fraser and the Director for Trustee Activities had observed the meeting of the Global Preparers' Forum (GPF) held in November 2013 and had reported positively on the level of attendance and the quality of participation and debate. The Director for Trustee Activities had also attended the November 2013 meeting of the Effects Analysis Consultative Group (EACG) and again reported positively on the level of attendance, participation and debate.

5. Reporting of Outreach and Fieldwork, and Correspondence

5.1 The DPOC received an update on the staff's continuing efforts to improve the transparency of:

a. the reporting of feedback from **outreach** with investors and other users of financial statements, particularly with respect to those persons and/or organisations who wished to remain anonymous. It was noted that the staff was looking to further improve the reporting of such meetings;

b. the reporting of the results of **fieldwork** undertaken on particular projects, noting in particular the results of the IASB's fieldwork carried out on the financial instruments: impairment project.

5.2 The DPOC noted that no new correspondence cases had been submitted since the October 2013 meeting.

END