# STAFF PAPER

May 2016

## REG IASB Meeting

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| **Project** | **Amendments to IFRS 4: Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts*** |
| Paper topic | Due process steps and permission for balloting |


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## Purpose of this paper

1. Agenda Papers 14B–14E for this meeting ask the International Accounting Standards Board (the Board) to consider the remaining technical issues on the narrow-scope project *Applying IFRS 9* Financial Instruments (IFRS 9) *with IFRS 4* Insurance Contracts (IFRS 4) (Amendments to IFRS 4). Provided that the Board makes the decisions requested in Agenda Papers 14B–14E, the staff will have sufficient decisions in order to proceed to draft the amendments to IFRS 4.

2. The Amendments to IFRS 4 permit two approaches, the overlay approach and a temporary exemption from applying IFRS 9 (the temporary exemption), to address the concerns raised by some stakeholders about the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard.

3. This paper:

   (a) describes the effects of the Amendments to IFRS 4 (paragraphs 5-18);

   (b) considers the due process steps undertaken by the Board in completing the narrow-scope project Amendments to IFRS 4 (paragraphs 19-25 and the Appendix A); and

   (c) requests the Board's permission to start the balloting process for the final amendments to IFRS 4, and asks if there are any planned dissents at this stage.

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4. Agenda Paper 14A *Summary of the Board's decisions and staff recommendations* for this meeting provides a summary of additional background information:

   (a) the history of the project, including the proposals in the Exposure Draft *Applying IFRS 9* Financial Instruments *with IFRS 4* Insurance Contracts (Proposed amendments to IFRS 4) (the ED);

   (b) the Board's tentative decisions during its redeliberations at previous meetings; and

   (c) the consequences of the Board's tentative decisions to date and this month's staff recommendations.

## Effects analysis

5. Paragraphs 3.75 of the IFRS Foundation *Due Process Handbook* (February 2013) specifies the criteria by which the Board should evaluate the likely effects of a new Standard. In applying those criteria, the Board has evaluated the likely effects of the amendments, considering the following factors:

   (a) how the overlay approach and the temporary exemption affect the financial statements of entities with contracts within the scope of IFRS 4;

   (b) whether the changes improve the comparability of financial information between different reporting periods for an individual entity and between different entities in a particular reporting period;

   (c) whether the changes improve the ability of users of financial statements to assess the future cash flows of an entity;

   (d) whether the improvements to financial reporting will result in better economic decision-making;

   (e) the likely effect on compliance costs for preparers; and

   (f) whether the likely costs of analysis for users of financial statements are affected.

*Financial statements of entities with contracts within the scope of IFRS 4*

6. The amendments to IFRS 4 would affect only entities that issue contracts within the scope of IFRS 4 that have yet to apply IFRS 9 (other than the own credit requirements in isolation[1]). Accordingly, entities that do not issue contracts within the scope of IFRS 4, or that have already applied IFRS 9, will not be affected by the changes.

7. The overlay approach that would be permitted by the amendments reclassifies the effect of applying IFRS 9 for qualifying financial assets from profit or loss to other comprehensive income (OCI). That approach will affect the financial statements as follows:

   (a) the profit or loss reported in the statement of comprehensive income will be different relative to entities that apply IFRS 9 without the overlay approach. However, there will be no change in the carrying amounts reported on the statement of financial position, or in the total comprehensive income relative to the outcome if the entity had applied IFRS 9 without the overlay approach;

   (b) entities will present a single, separate line item for the overlay adjustment in the statement of profit or loss, and present the overlay adjustment in OCI separately from other components of OCI; and

   (c) entities will provide disclosures to explain how the overlay adjustment is calculated and the effect of the adjustment on the financial statements.

8. The amendments also, as an alternative, permit a qualifying entity to defer the application of IFRS 9 until the earlier of a fixed expiry date or the date when the forthcoming insurance contracts Standard is applied. The application of the temporary exemption will affect the financial statements as follows:

   (a) the carrying amounts reported in the statement of financial position and the profit and loss and total comprehensive income reported in the statement of comprehensive income will be different relative to the

[1] IFRS 9 is effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted. In addition, for annual periods beginning before 1 January 2018, an entity may elect to early apply only the own credit requirements in IFRS 9 without applying the other requirements in that Standard.

outcome if the entity had applied IFRS 9. However, there would be no effect on the financial statements as an entity will continue to apply IAS 39, which is what they are applying today; and

(b) there will be disclosure to enable comparison between entities that apply the temporary exemption and other entities.

*Comparability*

9. The Board acknowledges that the financial statements of entities that apply the overlay approach or the temporary exemption will not be directly comparable with entities that apply IFRS 9. Furthermore, making both those approaches optional also reduces comparability between entities. However, the Board has sought to mitigate the concerns about comparability as follows:

(a) the presentation requirements of the overlay approach would isolate the effects of the overlay approach in a single, separate line item in profit or loss. These presentation requirements would assist users of financial statements to compare entities that apply the overlay approach and those that apply IFRS 9 without the overlay approach;

(b) restricting the scope of the temporary exemption is intended to ensure that the lack of comparability arising from the temporary exemption affects only peers within the insurance industry. In addition, the Board expects, based on the feedback received, that entities in a particular jurisdiction that qualify for the temporary exemption are highly likely to select the same options relating to the overlay approach or the temporary exemption, reducing the lack of comparability in practice;

(c) the disclosure requirements would provide some information that could be used to compare entities that apply the temporary exemption and those that apply IFRS 9; and

(d) a fixed expiry date for the temporary exemption, and the Board's commitment to completing the forthcoming insurance contracts Standard expeditiously, means that any reduction in comparability would exist only for a short period of time (ie until the temporary exemption expires or the forthcoming insurance contracts Standard is applied).

10. Nevertheless, the Board acknowledges that ‘perfect’ comparability cannot be achieved by those decisions because ‘perfect’ comparability is achieved only if all entities apply IFRS 9 when it is effective (or by requiring all entities to defer that Standard, which the Board believes would be a disproportionate response to the issues raised because this would mean that preparers and users would not benefit from the better reporting that results from applying IFRS 9).

*Usefulness in assessing the future cash flows of an entity and better economic decision-making*

11. The Board has received mixed feedback as to whether the amendments would result in financial statements that are more useful in assessing the cash flows of an entity, as follows:

(a) many users of financial statements did not support the temporary exemption, because:

(i) the additional accounting mismatches and temporary volatility that could arise in profit or loss if IFRS 9 is applied before the forthcoming insurance contracts Standard would not make their analysis more difficult; and

(ii) they already see volatility when analysing insurance entities and they are able to make the adjustments necessary to understand the financial performance of such entities.

(b) however, some users expressed concerns about potential increased volatility in profit or loss and supported the overlay approach, the temporary exemption, or both, because such volatility would;

(i) make financial statements of insurance entities even less understandable and less attractive for investment; and

(ii) make it more difficult to predict long-term economic performance and to forecast earnings based on profit or loss information.

12. The Board expects that the temporary exemption would not negatively affect a user's ability to assess an entity's future cash flows relative to the existing situation. This is because the entity would continue to apply the existing requirements of IAS 39 so the status quo is maintained. However, the amendments would not result in better economic decision-making for users of financial statements that would be available from entities applying IFRS 9, and may cause worse economic decision-making because of the reduced comparability noted in paragraph 9. The Board has sought to mitigate the concern about comparability as described in paragraph 9.

13. The Board expects that users will have better information to assess future cash flows and make economic decisions if an entity applies the overlay approach. This is because entities applying the overlay approach are applying the improved financial instruments requirements in IFRS 9 relative to those entities applying the temporary exemption. In addition, entities applying the overlay approach would provide additional information to users of financial statements that would help them to understand the effects of IFRS 9.

*Effect on compliance costs for preparers*

14. The temporary exemption will increase the compliance costs for preparers relative to applying IAS 39 because of the costs of the additional disclosures. However, the Board does not consider the costs of those additional disclosures onerous because those disclosures, described in paragraph 8(b), do not require the entity to apply IFRS 9 in its entirety, and in particular, do not require the application of the expected credit loss model in IFRS 9. Other than the costs arising from those additional disclosures, there would be minimal costs for preparers that apply the temporary exemption because those preparers would continue to apply their existing accounting.

15. Applying the overlay approach by itself would not be more costly relative to applying IAS 39 because IAS 39 already requires entities to disclose the fair value information for the eligible assets and that is the only additional information needed to apply the overlay approach. However, applying the overlay approach would be more costly than applying:

(a) only IFRS 9, because it would mean that an entity would need to identify and track the designated financial assets that the entity newly measures at fair value through profit or loss (FVPL) in their entirety applying IFRS 9; and

(b) the temporary exemption, because entities applying the overlay approach will also be incurring the costs to apply IFRS 9.

However, the Board notes that all entities applying the temporary exemption will be applying IFRS 9 in the future and thus will incur the necessary costs to do so in the future.

16. Finally, the Board notes that an entity will not be required to incur excessive costs as a result of applying the overlay approach. This is because:

(a) if the costs are excessive, an entity could choose not to apply the overlay approach and instead explain any additional accounting mismatches and temporary volatility to its investors; and

(b) the entity would already have a system in place for determining cost or amortised cost of such assets, on the basis that the overlay approach would apply only if the entity was not measuring the financial assets at FVPL in their entirety applying IAS 39. In addition, if the assets were previously classified as available-for-sale, the entity would already need fair value and amortised cost information to apply IAS 39.

### *The costs of analysis for users of financial statements*

17. The overlay approach and the temporary exemption may increase the costs of analysis for users of financial statements, particularly if a user of financial statements invests across sectors and one of the sectors is insurance. This is because the amendments reduce comparability, especially as the temporary exemption and the overlay approach are optional. The Board has sought to mitigate this concern as described in paragraph 9. Further, the Board notes that the overlay approach provides mitigating benefits for users of financial statements because it would allow an entity to address the concerns about the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard in a

transparent manner, while applying the improved financial reporting requirements in IFRS 9.

18. Although those who support the temporary exemption believe that it avoids the volatility and accounting mismatches that could arise from applying IFRS 9 before the forthcoming insurance contracts Standard, the Board noted that, if an entity applies the temporary exemption, users of financial statements will not be provided with improved information applying IFRS 9. The Board has consequently mitigated that loss of information by:

(a) limiting the temporary exemption to entities whose activities are predominantly related to insurance;

(b) requiring that a qualifying reporting entity elect to apply either IAS 39 or IFRS 9, but not both;

(c) requiring additional disclosures; and

(d) setting a fixed expiry date.

## Due process considerations

### *Considering re-exposure criteria*

19. Paragraph 6.25 of the IFRS Foundation *Due Process Handbook* (February 2013) specifies the criteria by which the Board assesses whether the proposals can be finalised or whether they should be re-exposed.

20. In considering whether there is a need for re-exposure, the Board:

(a) identifies substantial issues that emerged during the comment period on the ED and that it had not previously considered;

(b) assesses the evidence that it has considered;

(c) determines whether it has sufficiently understood the issues, implications and likely effects of the new requirements and actively sought the views of interested parties; and

(d) considers whether the various viewpoints were appropriately aired in the ED and adequately discussed and reviewed in the Basis for Conclusions.

21. The staff think that the changes that the Board made to the ED proposals during redeliberations are not fundamental and respond to the feedback received. Outreach has been conducted to actively seek the views of preparers, users of financial statements and regulators.

22. Consequently, we think that, on the basis of the re-exposure criteria in paragraphs 6.25–6.29 of the *Due Process Handbook*, the proposed amendments to IFRS 4 should be finalised without re-exposure.

## *Confirmation of due process steps and permission to ballot*

23. In Appendix A of this paper the staff have summarised the due process steps taken in developing the amendments to IFRS 4. The staff note that the required due process steps, and some of the optional steps, for the issue of the final amendments have been completed.

24. If the Board is satisfied that it has been provided with sufficient analysis, and has undertaken appropriate consultation and due process, to support the issue of the final amendments, the staff request permission to start the balloting process. The staff are targeting the issue of the amendments in September 2016.

## *Dissents*

25. Three Board members voted against the publication of the ED. Any Board member who intends to dissent from the issue of the final amendments is asked to make their intention known at this meeting.

**Questions for the Board**

1. **Re-exposure:** does the Board agree that the amendments to IFRS 4 should be finalised without re-exposure?

2. **Permission to ballot:** is the Board satisfied that the due process requirements have been met and that it has undertaken sufficient consultation and analysis to begin the balloting process for the amendments?

3. **Dissents:** do any Board members intend to dissent from the publication of the amendments?

# Appendix A—Action taken to meet the due process requirements

A1. The following table sets out the due process steps followed by the Board that are required for the final amendments to IFRS 4.

| *Step* | *Required/ Optional* | *Metrics or evidence* | *Evidence provided to DPOC* | *Actions* |
|---|---|---|---|---|
| **Consideration of information gathered during consultation** | | | | |
| **The Board posts all of the comment letters that are received in relation to the ED on the project pages.** | Required if request issued | Letters posted on the project pages. | The Board has reported on progress as part of its quarterly report at Trustee meetings, including summary statistics of respondents. | All comment letters that the Board has received on the ED (96 comment letters) have been posted on the project page of the IFRS Foundation website.<br><br>A comment letter analysis was presented to the Board at its March 2016 meeting (see Agenda Papers 14–14C [2]), and is available on the project page of the IFRS Foundation website.<br><br>Progress has been reported in the quarterly report at Trustee meetings. |
| **Round-tables between external participants and members of the Board.** | Optional | Extent of meetings held. | The DPOC has received a report of outreach activities. | Formal round-table meetings were not considered necessary in the light of the extensive outreach performed by staff with the affected preparers and users, which is a limited population. |
| **Board meetings are held in public, with papers being available for observers. All decisions are made in public sessions.** | Required | Meetings held.<br><br>Project website contains a full description with up-to-date information.<br><br>Meeting papers posted in a timely fashion.<br><br>Extent of meetings with consultative group held and confirmation that critical issues have been reviewed with them. | The Board and the DPOC have discussed progress on major projects, in relation to the due process being conducted.<br><br>The Board and the DPOC have reviewed the due process over the project life cycle, and how any issues about the due process have been/are being addressed.<br><br>The DPOC has met with the Advisory Council to understand stakeholders' perspectives.<br><br>The DPOC has reviewed and responded to comments on due process as appropriate. | The Board has discussed the interaction of IFRS 4 and IFRS 9 prior to the finalisation of the effective date of IFRS 9 (in seven Agenda Papers between 2009 and 2014). The Board has also discussed the interaction in January, March, May to October 2015 and March to May 2016.<br><br>Details of the project are available on the IFRS Foundation website. The website contains a full description of the project with up-to-date information on progress, including meeting papers and decision summaries (all posted on a timely basis).<br><br>The DPOC has been updated during its quarterly meetings on the status of the proposed amendments to IFRS 4. |

[2] The papers are available on the project website page (http://www.ifrs.org/Current-Projects/IASB-Projects/Different-effective-dates-of-IFRS-9-Financial-Instruments-and-the-new-insurance-contracts-Standard/Pages/Board-discussion-and-papers-stage-2.aspx).

| Step | Required/ Optional | Metrics or evidence | Evidence provided to DPOC | Actions |
|---|---|---|---|---|
| **Analysis of likely effects of the forthcoming Standard or major amendment, for example, costs or on-going associated costs.** | Required | Publication of the Effect Analysis. | The Board and the DPOC have reviewed the results of the Effects Analysis and how it has considered such findings in the proposed Standard.<br>The Board has provided a copy of the Effect Analysis to the DPOC at the point of the Standard's publication. | An analysis of likely effects of the amendments is included in the paragraphs 5-18 of this paper. The DPOC will receive a copy of this paper. |
| **Email alerts are issued to registered recipients.** | Optional | Evidence that alerts have occurred. | The DPOC has received a report of outreach activities. | Subscribers on the insurance contracts project have been notified when updates to the project website have been made using the News section of the project page and subscriber email alerts. |
| **Outreach meetings to promote debate and hear views on proposals that are published for public comment.** | Optional | Extent of meetings held, including efforts aimed at investors. | The DPOC has received a report of outreach activities. | The IASB staff conducted outreach with approximately 70 users of financial statements from multiple jurisdictions, and have also discussed the topic extensively with groups such as the Capital Markets Advisory Committee (CMAC) and the Corporate Reporting Users Forum (CRUF) after the publication of the ED.<br>Approximately 20 meetings with constituents, other than users of financial statements, were also conducted after the publication of the ED[3]. |
| **Regional discussion forums are organised with national standard-setters and the Board.** | Optional | Extent of meetings held. | The DPOC has received a report of outreach activities. | Regional discussion forums were not considered necessary in the light of the extensive outreach performed by staff with the affected preparers and users, which is a limited population. |
| **Finalisation** | | | | |
| **Due process steps are reviewed by the Board.** | Required | Summary of all due process steps have been discussed by the Board before a Standard is issued. | The DPOC has received a summary report of the due process steps that have been followed before the Standard is issued. | This Agenda Paper provides a summary of all due process steps and will be discussed by the Board at the May 2016 meeting. |
| **Need for re-exposure of a Standard is considered.** | Required | An analysis of the need to re-expose is considered at a public Board meeting, using the agreed criteria. | The Board has discussed its thinking on the issue of re-exposure with the DPOC. | Paragraph 21 of this Agenda Paper considers the need for re-exposure of the amendments. There are no fundamental changes to the proposals in the ED. Consequently it is unlikely that re-exposure would reveal any new concerns, so the staff recommend that the Board should not re-expose the amendments. |

[3] At some of those meetings, attendees discussed also the forthcoming insurance contracts Standard.

| *Step* | *Required/ Optional* | *Metrics or evidence* | *Evidence provided to DPOC* | *Actions* |
|---|---|---|---|---|
| **The Board sets an effective date for the Standard, considering the need for effective implementation, generally providing at least a year.** | Required | Effective date set, with full consideration of the implementation challenges. | The Board has discussed any proposed shortening of the period for effective application with the DPOC. | Agenda Paper 14C *Fixed expiry dates and other aspects of the temporary exemption and the overlay approach* recommends that the Board confirm the effective date proposed in the ED. The staff think that the effective date proposed in the ED allows for sufficient implementation time by preparers, given the nature of the amendments and the fact that they are optional. |
| **Drafting** | | | | |
| **Drafting quality assurance steps are adequate.** | Required | The Translations team has been included in the review process. | The DPOC has received a summary report of the due process steps that have been followed before a Standard is issued. | To be completed in due course. The Translations team will be asked to review the pre-ballot draft as part of the balloting process to take into account the need for language in the proposed document that is translatable into other languages. |
| **Drafting quality assurance steps are adequate.** | Required | The XBRL team has been included in the review process. | The DPOC has received a summary report of the due process steps that have been followed before a Standard is issued. | To be completed in due course. The XBRL team will be asked to review the pre-ballot draft as part of the balloting process to take into account the need for language in the proposed document that is translatable into the IFRS XBRL Taxonomy. |
| **Drafting quality assurance steps are adequate.** | Optional | The Editorial team has been included in the review process.<br>In addition, external reviewers used to review drafts for editorial review and the comments collected have been considered by the Board. | The DPOC has received a summary report of the due process steps that have been followed before an ED is issued, including the extent to which external reviewers have been used in the drafting process. | To be completed in due course. The staff have begun discussions with the editorial team about the timing of their review. The staff will be liaising with the editorial team and provide drafts for them to review in the finalisation of the amendments.<br>The staff intend to send a draft of the amendments to external parties for fatal flaw review before finalisation. This process allows external parties to review and report back to the staff on the clarity and understandability of the draft. |
| **Drafting quality assurance steps are adequate.** | Optional | Draft for editorial review has been made available to members of the IFASS and the comments have been collected and considered by the Board. | The DPOC has received a summary report of the due process steps that have been followed before a Standard is issued. | To be completed in due course. As usual, a draft will be made available on an internal site accessible by members of the International Forum of Accounting Standard-Setters. |
| **Drafting quality assurance steps are adequate.** | Optional | Draft for editorial review has been posted on the project website. | The DPOC has received a summary report of the due process steps that have been followed before a Standard is issued. | The staff do not intend to publish a draft of the amendments on the project website. The amendments have not been fundamentally changed from the ED.<br>However, the staff intend to send a draft of the amendments to external parties for fatal flaw review before finalisation. |

| *Step* | *Required/ Optional* | *Metrics or evidence* | *Evidence provided to DPOC* | *Actions* |
|---|---|---|---|---|
| **Publication** | | | | |
| **Press release to announce final Standard.** | Required | Press release has been announced in a timely fashion.<br>Media coverage of the release. | The DPOC has received a copy of the press release and a summary of the media coverage. | To be completed in due course. |
| **A Feedback Statement is provided, which provides high level executive summaries of the Standard and explains how the Board has responded to the comments received.** | Required | Publication of the Feedback Statement. | The Board has provided a copy of the Feedback Statement to the DPOC at the point of the Standard's publication. | Applicable only for new Standards. However, the staff plan to explain in the Snapshot how the Board has responded to the comments received. |
| **Podcast to provide interested parties with high level updates or other useful information about the Standard.** | Optional | Number of podcasts held. | The DPOC has received a report of outreach activities. | To be completed in due course. |
| **Standard is published.** | Required | Official release. | The DPOC has been informed of the release. | To be completed in due course. |