Summary note of the Accounting Standards Advisory Forum

Held on 3 October 2019 at the IFRS Foundation office, Columbus Building, 7 Westferry Circus, Canary Wharf, London E14 4HD.

This note is prepared by staff of the International Accounting Standards Board (the Board) and summarises the discussion that took place with the Accounting Standards Advisory Forum (ASAF).[1] *A full recording of the meeting is available on the IFRS Foundation® website.*

Region	**Members**
Africa	Pan African Federation of Accountants (PAFA)
Asia-Oceania (including one at large)	Asian-Oceanian Standard-Setters Group (AOSSG) Accounting Standards Board of Japan (ASBJ) Accounting Regulatory Department, Ministry of Finance PRC (ARD) Korea Accounting Standards Board (KASB)
Europe (including one at large)	European Financial Reporting Advisory Group (EFRAG) Autorité des normes comptables (ANC) Financial Reporting Council, UK (FRC) Organismo Italiano di Contabilità (OIC)
The Americas	Group of Latin American Accounting Standard Setters (GLASS) Canadian Accounting Standards Board (AcSB) Financial Accounting Standards Board, US (FASB)

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Financial Instruments with Characteristics of Equity

1. ASAF members discussed the range of project direction alternatives (together with their relative advantages and disadvantages) for the Financial Instruments with Characteristics of Equity project that were discussed by the Board at its September 2019 Board meeting.

2. Most ASAF members (PAFA, AOSSG, ARD, KASB, EFRAG, ANC, FRC, GLASS, AcSB, OIC) were supportive of the project direction tentatively decided on by the Board, ie making clarifying amendments to IAS 32 *Financial Instruments: Presentation* for one or more of the following reasons:

    (a) IAS 32 works well for most financial instruments. Starting from IAS 32 would minimise unintended consequences for those entities that do not have financial instruments that are subject to challenges when applying IAS 32.

    (b) many application challenges in IAS 32 arise from a lack of guidance that necessitates making judgements. Providing guidance on how to apply the IAS 32 requirements could resolve some of the application challenges.

    (c) this alternative will help to limit the concerns raised with respect to the 2018 Discussion Paper such as the use of new terminology and the understandability of new principles.

    (d) this alternative takes a pragmatic view, is a good compromise amongst the alternatives and would require a reasonable timeframe to develop.

3. Members of AOSSG, EFRAG, FASB, FRC and AcSB stressed that improving disclosures is critical for users of financial statements. They said users of financial statements want to understand the terms and conditions and potential dilution effect of financial instruments, more than the classification outcomes because they often make their own decisions on classification.

4. Members of AOSSG, FRC and OIC expressed the view that in an ideal world they would have preferred the Board undertaking a fundamental review to develop a new approach to distinguishing financial liabilities from equity. Nevertheless, AOSSG and FRC expressed their support for the project direction tentatively decided on by the Board because they acknowledged the difficulty of finding one common definition of financial liabilities and equity that all stakeholders would agree on and the longer timeframe such a project would likely require. However, AOSSG cautioned that as

the project progresses, the Board may find that it cannot address the issues without considering broader fundamentals. OIC added that their second preference would have been the Board starting with the Discussion Paper published in June 2018 but would also support the project direction the Board has decided.

5. ASBJ said that they would not disagree with narrow-scope amendments. However, they would support the Board undertaking a fundamental review to develop a new approach. If that is not considered feasible by the Board, they would support a disclosure-only approach. ASBJ added that they do not support the project direction tentatively decided by the Board because, in their view, it will be difficult to identify underlying principles within IAS 32 that are robust enough.

6. ARD and KASB provided examples of practice issues that are prevalent in their jurisdictions. These included:

    (a) accounting for non-controlling interest puts;

    (b) distinguishing the effects of laws and regulations from the contractual terms;

    (c) the application of the indirect obligation requirement and the impact of economic compulsion on contractual terms;

    (d) the classification of derivatives on own equity that contain anti-dilution clauses; and

    (e) accounting for the effects of conditionality in financial instruments with contingent settlement provisions.

7. In response to ASAF members’ comments, Board members clarified the following:

    (a) Classification outcomes may change as a result of making clarifying amendments to IAS 32. Two types of changes in classification outcomes can be distinguished:

        (i) the Board addresses accounting diversity, and by definition, an entity would be required to change its accounting classification of specific types of instruments.

        (ii) the Board may also require a change in classification outcome when it results in a more faithful representation of the actual economics of the financial instruments.

(b) The Board is mindful of the interaction between presentation and disclosure requirements and its decisions on classification. For example, it would be more efficient for stakeholders and the Board to consult on a comprehensive package that considers both classification and disclosures. Furthermore, developing disclosures independently of classification requirements may require the Board to revisit disclosures once amendments to classification requirements are developed.

Dynamic Risk Management

8. The objective of this session was to provide an update on the Dynamic Risk Management (DRM) project and request input from the ASAF members on potential ways forward with regards to outreach on the core version of the DRM model.

9. An EFRAG member was supportive of testing the core model at this stage and mentioned that EFRAG would be able to conduct an early-stage impact analysis.

10. The EFRAG member raised five matters:

(a) clarify the purpose of the DRM model and whether it is focused on reducing accounting mismatches or reflecting the effects of risk management activities in the financial statements. The EFRAG member suggested clarifying upfront what the purpose is and the existing tensions between accounting and risk management practices.

(b) consider how to operationalise the model. For example, how the 'benchmark derivatives', proposed by the core version of the DRM model, should be documented in a typical structure of a financial institution given the continuous rebalancing for risk optimisation purposes.

(c) recommend inviting both accounting experts and risk managers during the outreach, mainly focusing on banks which are the primary users of this model.

(d) suggest reaching out to regulators to understand how changes in derivatives fair value deferred in OCI could affect capital requirements.

(e) from a European perspective, it would be important to have a targeted test with entities that applied the carve-out version of IAS 39. This would be useful for those entities to compare the differences between their current accounting practices and the proposed DRM model.

11. A Board member noted that a perfect solution would be to reflect risk management activities and reduce accounting mismatch. However, entities often use ‘proxy hedges’ due to constraints in applying existing hedge accounting requirements to dynamic risk management strategies. This results in lack of transparency regarding the objective and economic effects of an entity’s risk management activities. Therefore, the purpose of this project should be to improve current accounting practice to better reflect risk management activities. Pursuing a perfect solution would increase the risk of the project not being successful.

12. The ASBJ member noted that there are many forms of interest rate risk management and the DRM model should accommodate those various forms. This member highlighted that the Board should ensure that all entities that are currently applying hedge accounting, are still able to do so when the new requirements replace IAS 39. The ASBJ member also asked whether users of financial statements should also be considered during the outreach. A Board member noted that, at this stage, the outreach should focus on preparers to first test if the proposed DRM model is operational.

13. The AOSSG and KASB members expressed the view that insurance entities should be included in the outreach. In particular, the KASB member mentioned that the insurance industry has a greater need of a DRM model in connection with the implementation of IFRS 17. Both members also suggested the Board considers forming a consultative group for the DRM project with the aim of improving the efficiency if the project.

14. Two members (ARD and AcSB) were supportive of performing outreach at this stage. The ARD member asked whether the DRM model could accommodate commodity price risk as many manufacturing companies from her jurisdiction dynamically manage commodity price risk. Similarly, the AcSB member suggested not to limit this model to interest rate risk and explore whether it is transferable to foreign currency risk as many entities from the manufacturing and mining industry in her jurisdiction are exposed to foreign currency risk.

15. In response to the suggestion to include other risks to the scope of the DRM model, such as foreign currency and commodity price risk, a Board member observed that the focus is on banks and interest rate risk management at this stage.

16. The GLASS member cautioned that it could be challenging to capture all different risk management strategies applied in practice in just one model.

IBOR Reform and its Effects on Financial Reporting

17. The objective of this session was to provide an update to the ASAF members on the IBOR Reform project and request further inputs from the ASAF members on potential accounting issues to be considered by the Board during Phase II of the project.

18. The EFRAG member noted that the EFRAG's comment letter on Phase 1 also outlines the potential Phase II issues raised by their constituents. The EFRAG member suggested that the Board should focus on the main Phase II issues by adopting a more principle-based approach and solving the most prominent ones first (ie modification and derecognition), which might also affect continuity in hedge accounting. The FRC member agreed with this view and highlighted the importance of prioritising the issues that are more urgent.

19. The ASBJ and AcSB members suggested that the Board considers the FASB's ongoing work as it would be helpful to have consistent principles and scopes.

20. The AOSSG member asked whether modification issues from the IFRS Interpretations Committee will be addressed in this project but acknowledged the tight timetable. The KASB member emphasised modification of financial assets as the most important issue as timing for IBOR reform gets closer. The KASB member noted that it might be necessary to review whether the IFRS Interpretations Committee's opinion on this issue should be maintained.

21. The ARD and AcSB members asked the Board to consider multiple exposure hedges for Phase II, where entities manage both foreign currency risk and interest rate risk at the same time.

22. The GLASS and AcSB members added that the Board should consider the implications to other IFRS Standards. They pointed out the classification within the fair value hierarchy in IFRS 13 as a potential area to be considered during Phase II.

Disclosure Initiative—Accounting Policy Disclosure

23. The objective of this session was to seek ASAF members' preliminary views on the Exposure Draft *Disclosure of Accounting Policies* (Exposure Draft).

24. Most ASAF members (FRC, KASB, OIC AcSB, EFRAG, FASB, PAFA and ARD) said that they generally agree with the proposed amendment to require entities to disclose their 'material' accounting policies instead of their 'significant' accounting policies.

25. The FRC and OIC members thought that the proposed amendment to IAS 1 *Presentation of Financial Statements* improves the link to the existing guidance in IFRS Practice Statement 2 *Making Materiality Judgements* and would assist preparers in eliminating immaterial disclosures. The KASB member concurred with this view as they thought the proposed amendments would enhance the visibility of critical information in the financial statements.

26. However, the ASBJ and EFRAG members were not sure that the proposed amendments would dramatically change current accounting practice or behaviour.

27. The AOSSG, OIC and EFRAG members added that some other languages do not distinguish between 'material' and 'significant' on translation.

28. The AOSSG, ASBJ, KASB, FRC and AcSB members also expressed concerns over the proposed new paragraph 117B of IAS 1. In particular, the FRC, AcSB and ASBJ members noted that the proposed new paragraph 117B(e) needed further clarification – they thought that accounting policy disclosures should already be entity-specific. Consequently, they were unsure of what the Board meant by 'entity-specific' in this particular circumstance.

29. The AOSSG, PAFA and FRC members also had sympathy for Mr Martin Edelmann's Alternative View to the Exposure Draft and said that:

    (a) users will always be interested in certain accounting policies even if they are not material to the financial statements; and

    (b) duplicating some of the recognition and measurement requirements of more complex IFRS Standards would be useful to less sophisticated users of financial statements.

30. The ASBJ, EFRAG and KASB members noted that the Board has an active project on IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* which seeks to make amendments to the definition of an accounting policy. These members thought it would be beneficial if the Board combined these projects to make their scope clearer and reduce the number of amendments to the Standard that are related to accounting policies.

Agenda planning and 2020 Agenda Consultation

31. In this session, ASAF members discussed:

    (a) the proposed agenda for the December 2019 ASAF meeting (paragraph 32-33)

    (b) the Board's intended approach for the 2020 Agenda Consultation *Request for Information* (paragraphs 34-38).

Update and agenda planning

32. The technical staff presented Agenda Paper 5, including the proposed agenda for the December 2019 ASAF meeting. Staff noted that members' advice would be requested on the:

    (a) post-implementation review of IFRS 10 *Consolidated Financial Instruments*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*; and

    (b) 2020 Agenda Consultation.

33. The FASB member proposed including on the agenda, for either the December 2019 meeting or the April 2020 meeting, its Invitation to Comment on *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*. The ASBJ member added that they can also provide an update on their joint goodwill paper with HKICPA.

2020 Agenda Consultation

34. The technical staff presented Agenda Paper 5A to brief ASAF members on the preparation status for the 2020 Agenda Consultation and ask members for their help in developing the *Request for Information*.

35. ASAF members agreed to discuss the project at the December ASAF meeting—specifically, to discuss and develop information about potential projects to include in

the Request for Information. Staff emphasised that the purpose of that meeting would not be to form a consensus view on those potential projects.

36. ASAF members commented on the need for clear articulation in the Request for Information—specifically:

(a) four ASAF members (EFRAG, FASB, FRC, AcSB) suggested that the Board consider how best to communicate its capacity to add new projects to its 2022-2026 workplan in the Request for Information. These members said that such clarity would be helpful for stakeholders to effectively balance their prioritisation of the potential projects.

(b) the ASBJ member said that the Board should articulate descriptions of the potential projects and Request for Information questions in a way that would allow stakeholders to provide views on whether any long-term projects should be undertaken.

(c) the AcSB member suggested that the Board consider how best to communicate the criteria for determining the appropriate work plan; in particular, how the Board will assess potential projects against the criterion on deficiency in reporting.

37. The FASB member asked whether projects that have been removed from the Board's agenda, but which the FASB has on its agenda, can be considered as potential projects for comment in the Request for Information. The technical staff responded that the only specific constraint, at this time, is that the potential projects to be considered for inclusion in the Request for Information must be those that are within the Board's current remit.

38. The EFRAG member said that the Board should focus its activities, in the 2022-2026 timeframe, on completing existing projects and the post-implementation review of recently issued Standards.

Accounting Policies and Accounting Estimates

39. The objective of the session was for ASAF members to discuss KASB's research project *A Revisit to the Definition of Accounting Estimates*.

40. A Board member emphasised that the Board's project on *Accounting Policies and Accounting Estimates* was narrow in scope and feedback on the related Exposure Draft confirmed that the Board should address only a known issue in practice (ie distinguishing between changes in accounting policies and changes in accounting estimates) and not fundamentally reconsider the notion of estimates and the process of estimation.

41. Some members suggested clarifying particular aspects of the research paper (FRC, ASBJ, AcSB).

    (a) The FRC member said it was not clear what problem needs to be resolved—whether there were too many (or not enough) prior year adjustments and whether confusions exist between changes in accounting estimates and accounting policies. The KASB member said there were practical challenges in distinguishing changes in accounting policies from changes in accounting estimates and said providing a clear definition of accounting estimates would help resolve those challenges.

    (b) The ASBJ member said it was not clear how the observations from the research led to the suggestions provided and how those suggestions would result in providing more useful information.

    (c) The AcSB member said most items in the financial statements cannot be measured through direct observation and suggested clarifying which items could be. The KASB member said particular items like cash, accounting receivables and bank borrowings might sometimes not require estimation.

42. The research paper recommends using the term 'measurement uncertainty' in the definition of accounting estimates and explores why measurement uncertainty exists. Comments on this aspect of the research paper included the following:

    (a) The AcSB member explicitly supported the use of the term 'measurement uncertainty' but said accounting estimates can also be relevant when considering whether to recognise or derecognise particular items in the financial statements;

(b) One Board member said the analysis and findings of why measurement uncertainty exists was useful;

(c) The ARD member said it would also be helpful to classify types of measurement uncertainty by building, as the starting point, on uncertainties that exist in transactions and events.

43. The EFRAG member reported that its members said the definition of accounting estimates proposed was not necessarily an improvement over that included in the Board's Exposure Draft. In their view, the definition would not necessarily address the challenges in distinguishing between change in accounting estimate and change in accounting policies. The member also reported that some of its members said it would not be appropriate to introduce constraints on revising accounting estimates.