Summary note of the Accounting Standards Advisory Forum

Held on 1 and 2 October 2015 at the IASB office, 30 Cannon Street, London

This note is prepared by staff of the International Accounting Standards Board (IASB), and is a high-level summary of the discussion that took place with the Accounting Standards Advisory Forum (ASAF). A full recording of the meeting is available on the IASB website.

ASAF members attending

Andreas Barckow	Accounting Standards Committee of Germany
Alexsandro Broedel Lopes	Group of Latin American Standard-Setters
Kim Bromfield	South African Financial Reporting Standards Council
Patrick de Cambourg	Autorité des normes comptables
Clement Chan	Asian-Oceanian Standard-Setters Group
Françoise Flores	European Financial Reporting Advisory Group
Alberto Giussani	Organismo Italiano di Contabilità
Russell Golden	Financial Accounting Standards Board
Lu Jianqiao	China Accounting Standards Committee
Linda Mezon	Accounting Standards Board of Canada
Yukio Ono	Accounting Standards Board of Japan
Kris Peach	Australian Accounting Standards Board and the New Zealand Accounting Standards Board

2015 Agenda Consultation

1. On 11 August 2015 the IASB published its Request for Views 2015 Agenda Consultation (RFV) for public consultation. The RFV is out for comment until 31 December 2015.

2. At its meeting in London on 28 September 2015 the World Standard-setters (WSS) discussed the RVF, in break-out groups. At this ASAF meeting, the Chair from each of the break-out groups presented a summary of the group's views to ASAF members for further discussion and development.

3. Five questions, taken from the RFV, were discussed by WSS and subsequently developed by ASAF members:

    (a) the factors used to allocate resources between Standards-level projects, research and maintenance and implementation;

    (b) the prioritisation of the research programme;

    (c) the level and mix of implementation support provided;

    (d) the pace of change and the level of detail given in IFRS; and

(e) a proposal to extend the interval between agenda consultations to five years.

Factors used to allocate resources

4. The chair of the WSS break-out group outlined the group's view of important factors that should be considered when allocating resources between Standards-level projects, research and implementation activities. The factors included:

    (a) the importance of the issue to users;

    (b) the urgency of the issue;

    (c) the importance of principle-based Standards—including that the principles need to be clear to prevent the need for disruptive change; and

    (d) convergence with US GAAP—however, the majority of the group did not consider convergence alone to be important.

5. The ASAF members discussed the standard-setting time cycle and when changes to IFRS should be made.

6. The ASAF also discussed post-implementation support and the Transition Resource Groups (TRGs). One ASAF member thought that it was wrong to set up the Revenue TRG so soon after issuing IFRS 15. Another member thought, however, that the TRG was an important and transparent way in which the IASB helped stakeholders to implement change.

7. There was a general discussion that the time taken to issue a final Standard was too long, although it was accepted that the IASB's due process and outreach needed to be robust and transparent and that this absorbed time. It was also noted that time was needed to change stakeholders' views, because they were naturally resistant to change. One ASAF member suggested that the IASB should undertake an effectiveness review of the project management on its completed projects.

8. In prioritising its work, ASAF members considered that:

    (a) The IASB should focus on general and cross cutting issues that apply to all IFRS Standards, such as the *Conceptual Framework* and the Disclosure Initiative.

    (b) Specific issues, such as extractive industries, are not as important as the higher level cross-cutting issues, such as intangible assets.

    (c) The IASB could progress some topics, such as extractive industries, by developing further the work already undertaken by national standard-setters.

    (d) Geographically widespread issues are more important than those affecting only a single jurisdiction.

    (e) The urgency of the topic should also be a factor.

    (f) When the IASB determines the priority, it might be helpful if the suggested factors are classified into those relating to 'relevance' and those relating to 'constraints'.

9. ASAF members noted the importance of implementation support and education activities. They also noted the need to recognise that preparers and auditors will have limited resource

available to comment on new proposals when they are implementing the significant new Standards, including Revenue, Financial Instruments and Leases. .

Prioritisation of the research programme

10. The Chair of this break-out group at the WSS meeting summarised the group's feedback, noting:

    (a) Topics should be prioritised if they are important to fill a gap in IFRS and they are capable of being solved through standard-setting activities.

    (b) Geographically widespread issues are more important than those affecting only a single jurisdiction.

    (c) Convergence was not considered to be a factor for prioritisation; improving the quality of IFRS was more important.

11. Using the factors above, the WSS break-out group had rated Principles of Disclosure and Financial Instruments with the Characteristics of Equity as the most important research projects. In third place were IAS 19 *Post-employment Benefits,* Primary Financial Statements and macro hedging.

12. ASAF members noted:

    (a) A key factor in prioritising projects on the research programme is who is affected by the project and by how much. The greater the number of affected entities, and the more significant the impact on those affected, the higher the priority.

    (b) The degree of diversity in practice is an important issue.

    (c) The IASB should look to the future to anticipate what topics will be important in a few years' time.

13. Several ASAF members supported national standard-setters (NSS) having a greater role in the IASB's research activities, whilst respecting the independence of the IASB and NSS.

14. One ASAF member stated that the project on goodwill should be expedited in that it should be classified as a Standard-setting project rather than a research project, considering the feedback received through the post-implementation review and the research initiatives of NSS and regional groups.

Level and mix of implementation support provided

15. The Chair of this break-out group at the WSS meeting summarised the group's feedback noting:

    (a) The IFRS Interpretations Committee needs to maintain a balance between the need to respond quickly and stakeholders' ability to absorb change.

    (b) TRGs could be helpful but should not be a required step in the IASB's due process.

    (c) Some members of the group thought there are too many narrow-scope amendments.

    (d) Others considered that submissions to the Interpretations Committee could be reviewed before being discussed in public.

(e) Support for the involvement of WSS in the initial outreach on agenda submissions to the Interpretations Committee, which aims to define the issue and identify whether the issue is widespread.

(f) Support for the work of the Education Initiative, but thought that greater use could be made of technology such as webcasts.

16. One ASAF member thought that TRGs had been a useful way of supporting the implementation of a complex Standard such as IFRS 15 *Revenue from Contracts with Customers*. Another ASAF member noted that it was important that all questions were answered before implementation, because changes introduced later in the implementation phase can be expensive to preparers. Other ASAF members noted that TRGs sent the wrong message about new standards and preferred they were not continued.

17. One ASAF member thought it was important to improve the quality of work done between the end of deliberations and issuing the final Standard. In that member's view, this process is not transparent. The ASAF member thought that errors in drafting were introduced at that stage. One ASAF member suggested that amendments to Standards should be batched up to make endorsement and adoption process in jurisdictions easier.

18. ASAF members noted that the crucial issue when changing IFRS is to fully understand the problem before attempting to resolve it and that sometimes the "simple" fix introduced more complexity, so it is preferable to resolve the real underlying issues.

Pace of change and the level of detail given in IFRS

19. The Chair of this break-out group at the WSS meeting summarised the group's feedback, noting:

(a) That the pace of change is affected by how long the entity has been reporting in accordance with IFRS. Generally, participants in the break-out group thought the pace of change was about right.

(b) Views among members of the break-out group about the level of detail included in Standards were divided–some thought too much guidance was provided; others thought too little guidance was provided–depending on the Standard.

(c) All members of the break-out group agreed that clear principles are required in IFRS—clear principles should mean that the IASB would not have to deal with individual issues.

(d) Some held the view that it was difficult to engage with stakeholders throughout the standard-setting process. Some members thought that *IASB Update* did not provide a clear enough description of the IASB's thinking, so that stakeholders were surprised by the final IFRS.

(e) There is a perceived gap between the thinking at the end of deliberations and issuing the Standard itself.

20. The ASAF discussed how to address the perceived gap between the thinking at the end of deliberations and issuing the Standard. Some ASAF members suggested preparing a staff draft before issuance for either public or restricted exposure. IASB staff noted that the insurance project's decision summary was a useful way of filling this gap.

Proposal to extend the interval between agenda consultations to 5 years

21. The Chair of this break-out group at the WSS meeting explained that the group generally preferred a 5-year interval between agenda consultations as 5 years aligns with the term of office for IASB members and of the IASB's Chair. Some had expressed concern at the consultation burden placed on stakeholders.

22. ASAF members noted that:

    (a) because of the length of time taken by the agenda consultation process, the elapsed time between agenda consultations is 5 years in reality, notwithstanding the nominal 3-year interval.

    (b) the agenda should be managed more dynamically, with ASAF carrying out an annual review.

    (c) flexibility is an important aspect of the agenda consultation.

    (d) 5 years would be a suitable interval, if there was a built-in mechanism for interim reviews of the agenda to allow for urgent or critical issues.

Conceptual Framework

23. At this meeting ASAF members discussed:

    (a) Feedback from the WSS meeting on:

        (i) possible implications for IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* of the proposals in the *Conceptual Framework* Exposure Draft;

        (ii) the proposals on measurement in the *Conceptual Framework* Exposure Draft;

    (b) Possible implications of the *Conceptual Framework* Exposure Draft for the Rate-regulated Activities project.

Feedback on the possible implications for IAS 37 of the *Conceptual Framework* proposals

24. WSS participants in two break-out groups had been asked to comment on an IASB staff paper that set out staff views on how the concepts proposed in the *Conceptual Framework* Exposure Draft might guide the IASB's decisions, if those concepts are finalised and if the IASB takes onto its work plan a project to amend aspects of IAS 37.

25. The Chairs of those break-out groups reported that:

    (c) Participants had expressed support for the idea of testing the implications of the *Conceptual Framework* proposals. Some had suggested that the IASB should carry out similar exercises for other types of transactions as the IASB completes the project.

    (d) Participants had concluded that the proposed concepts would guide the IASB in broadly the right direction if it were to amend IAS 37. However, participants had expressed some reservations.

(e) Both groups had focussed primarily on the implications of the proposed concepts for identifying liabilities. On this topic, the main concern was that the proposed description of a 'present obligation' would broaden the definition of a liability further than was intended and further than would be desirable. The proposed definition seemed, to some, to encompass future costs (such as audit fees and start-up costs) and dividends.

(f) On the topic of recognition, participants in both groups had started by expressing a view that items meeting the definition of an asset or a liability should be recognised in the financial statements, unless there was a good reason for excluding them. However, participants had gone on to acknowledge the need to consider relevance, faithful representation and, in particular, cost-benefit considerations. Participants in one group had questioned whether a low probability of future inflows or outflows should, in itself, be a reason for not recognising an asset or a liability—they had suggested that measurement uncertainty was a more important factor. Participants in one group had debated the threshold at which the probability of future outflows should be regarded as 'low'. Probabilities of 30-40 per cent were suggested.

(g) On the topic of measurement, participants had generally supported the conclusions in the staff paper. In particular, they had supported the focus on fulfilment value for liabilities within the scope of IAS 37, though some had suggested that a more appropriate notion for such liabilities would be one of fulfilment 'cost', ie a measure that would exclude risk adjustments.

26. In the discussion that followed, ASAF members echoed WSS participants' concerns that the proposed description of a present obligation might be broadening the definition of a liability too much. In particular, members suggested that there was a need to be more precise about the meaning of 'activities conducted by the entity' in the description of a past event. Although the guidance proposed in the Exposure Draft seemed to work well when applied to the examples in the staff paper, it might not work so well for other future transfers, such as preference and ordinary dividends, audit fees, and clean-up costs for which there is no obligation beyond economic compulsion. The IASB staff said they would consider those examples.

27. An IASB member present noted that some of the examples related to liability-equity classification, which might suggest that any future project to amend IAS 37 should await progress on the IASB's Financial Instruments with Characteristics of Equity project.

28. On the topic of recognition:

(a) one ASAF member noted that it remains unclear how the IASB will apply the proposed recognition concepts in other situations.

(b) some ASAF members echoed the WSS participants' view that a low probability of future inflows or outflows should not in itself be a reason for omitting an asset or a liability from the financial statements.

(c) one ASAF member suggested that it might be possible to be more specific about the situations in which there is no need to prescribe a probability threshold. He hoped to be able to provide detailed suggestions to the IASB.

29. On the topic of measurement, one ASAF member suggested that the IASB should give more consideration to measurement bases in which measures of future cash flows are updated, but the rates used to discount the cash flows are not updated—the Exposure Draft contained no discussion of such measurement bases. That ASAF member expressed a view that updating discount rates does not provide useful information about assets or liabilities that will be held until they are realised or settled by the entity. An IASB member noted that such measures can be difficult to apply in practice to liabilities that arise incrementally and change over time.

Feedback on the proposals on measurement

30. The *Conceptual Framework* Exposure Draft proposes a range of factors that should be considered when selecting a measurement basis. Participants at the WSS meeting were asked to discuss those factors and apply them to different types of assets and liabilities.

31. The Chairs of the break-out groups at the WSS meeting made the following observations about the discussion in their groups:

(a) One group used most of the factors listed in the Exposure Draft when selecting measurement bases. However, in applying those factors, members of the group came to different conclusions about the most appropriate measurement basis for particular assets and liabilities. Participants in this group found it difficult to distinguish the characteristics of an asset or liability from measurement uncertainty, and hence, did not refer to the characteristics of the asset or liability when selecting measurement bases.

(b) Participants in one group found that they selected a measurement basis first and then used the factors to justify their selection (rather than the other way round).

(c) One group found the factors to consider more helpful for liabilities than for assets, especially the guidance on how a liability contributes to future cash flows.

(d) The level of measurement uncertainty associated with particular measurement bases and cost-benefit considerations were considered to be an important factor by many of the participants.

(e) The effect of selected measurement bases on financial performance was considered important by many and some expressed the view that the effect of a measurement basis on financial performance should be given greater priority than its effect on financial position.

(f) It was noted that many participants were more comfortable with the use of fair value for financial instruments than for other types of assets or liabilities.

(g) Some participants called for more discussion of the distinction between measurements based on entry values and those based on exit values.

(h) Some participants expressed the view that how an asset or liability contributes to future cash flows should be given greater priority than the characteristics of the asset or liability.

(i) Some participants expressed the view that capital maintenance concepts should be discussed in the measurement chapter of the *Conceptual Framework*.

(j) Some participants expressed views that current cost should be given more prominence in the *Conceptual Framework* and that current cost, which might result in more relevant information about margins, should be discussed.

(k) One of the groups found the tables summarising the information provided by the different measurement bases useful when selecting a measurement basis. However, other groups stated that they did not use them. Some participants stated that the treatment of transaction costs in the tables should be explained more clearly.

32. ASAF members discussed the feedback from the WSS meeting and commented on the measurement proposals in the Exposure Draft.

33. One ASAF member expressed general support for the measurement chapter but also expressed the following views:

(a) There should be a more explicit link between the selection of a measurement basis and the objective of financial reporting.

(b) Measurement uncertainty should not be part of relevance but, instead, part of faithful representation.

(c) How an asset is realised (generating cash flow directly or indirectly) is important for the selection of a measurement basis. However, this can change over time so it is important to consider whether there are any impediments to changing the way in which an asset is realised.

34. One ASAF member also questioned whether it is necessary to categorise measurement bases (historical cost and current value). He noted that historical cost is usually updated and some current value measurements use inputs based on historical cost. In his view, focussing on the content of the measurement bases is more important than the category to which they belong. However, some IASB members and some ASAF members disagreed with this view, arguing that categorising measurement bases helps to impose discipline on the IASB when selecting a measurement basis and can help to communicate the objective of a selected measurement basis. Another ASAF member stated that the two points of view were not necessarily antagonistic, as focusing on the information content of the measurement might be most helpful in the standard-setting activity whereas the categories are helpful in describing the requirements and the policies that are applied.

35. Some ASAF members stated that the *Conceptual Framework* should include a measurement objective. The objective of measurement should be known before a measurement basis can be selected. One ASAF member suggested the objective of measurement should refer to the amount and the uncertainty of cash flows and management's stewardship.

36. One ASAF member stated that the risks associated with a particular asset or liability are important and, hence, the characteristics of an asset or liability are an important factor to consider when selecting a measurement basis.

37. Some ASAF members favoured giving more weight to one factor (the way in which an asset or liability contributes to future cash flows) than to another factor (the characteristics of the asset or liability). Views were also expressed that two separate discussions are needed to clarify how the factors can help in selecting measurement bases for the statement of financial position and separately, the statement of financial performance. The reporting of performance should be given priority.

38. One ASAF member expressed the view that historical cost measurements reflect asymmetric prudence, but noted that the *Conceptual Framework* Exposure Draft does not acknowledge that asymmetric prudence might sometimes be useful.

39. ASAF members and IASB members discussed impairment reversals and questioned why it was not possible to recognise an increase in value above original cost. The IASB staff noted that the *Conceptual Framework* Exposure Draft explains that the objective of historical cost is to portray the recoverable cost of an asset. Restricting impairment reversal to the original cost is consistent with this objective.

40. One ASAF member noted that a measurement such as amortised cost was difficult to categorise, and that it was not self-evident that amortised cost would belong to the historical cost category. Amortised cost reflects both increases and decreases in expected cash flows. However, most people understand "historical cost" to mean that one would always reflect the downsides, but not the upsides.

41. Some ASAF members expressed the view that, when an asset contributes to cash flows indirectly, the most relevant measurement basis would be historical cost. Other members stated that they support the use of historical cost on cost-benefit grounds but that current measurement bases (including current cost) often provide more relevant information.

42. ASAF members discussed the linkage between measurement and capital maintenance. Some thought that the measurement section of the *Conceptual Framework* should discuss capital maintenance. A chair of the break-out groups at the WSS meeting noted that if a physical capital maintenance concept were to be adopted, a single measurement basis (current cost) would be needed. The use of a single measurement basis was not supported by most ASAF members.

43. Some ASAF members stated that the use of Other Comprehensive Income, in reducing the need to compromise between what is more relevant from an income statement perspective and what is more relevant for the statement of financial position, might help to widen the use of current value measurement bases in the statement of financial position, and hence enrich the information content of financial statements.

Possible implications of the *Conceptual Framework* Exposure Draft for the Rate-regulated Activities project

44. In July 2015, ASAF members were asked to provide views about possible accounting approaches that could be developed to reflect the financial effects of a type of rate regulation described as 'defined rate regulation' in the Discussion Paper *Reporting the Financial Effects of Rate Regulation*, published in September 2014 (the Rate Regulation DP). ASAF members expressed mixed views, summarised as follows:

(a) Some ASAF members considered that the existing predominant IFRS accounting practice should be retained, without adjustment to reflect the financial effects of rate regulation. The existing IFRS practice is to recognise revenue using the quantity of goods or services delivered to customers and the regulated rate, without any adjustment for amounts included in the regulated rate related to:

    i. goods or services delivered to customers in a different period;
    ii. other specified activities carried out in a different period; or
    iii. adjustments for variances from estimates relating to past periods.

(b) Some ASAF members supported making adjustments to the existing predominant IFRS practice. Some of those ASAF members were comfortable with recognising a regulatory liability in cases in which the consideration was included in amounts billed to customers in advance of the entity carrying out the specified activity. In contrast, they were not comfortable with recognising a regulatory asset when the activity was carried out in advance of billing to customers. This suggested a preference for recognising the related consideration at the later of:

    i. billing customers; and
    ii. carrying out the specified activity.

45. In this meeting, ASAF members were asked to provide a basis for the views that they expressed in the July meeting about reporting the financial effects of rate regulation. In particular, ASAF members were asked to relate their views to the concepts proposed in the *Conceptual Framework* ED.

46. ASAF members discussed the scope and description of defined rate regulation and whether it created financial effects that were not reflected in the current practice, which reiterated the concerns expressed prior to publishing the Rate Regulation DP. Some ASAF members questioned whether the rights and obligations described in the Rate Regulation DP could be enforced and whether the financial effects described could be identified in practice.

47. One ASAF member noted that the responses to the Rate Regulation DP established that there is demand from users and preparers of financial statements to more clearly represent the financial effects of defined rate regulation than is currently achieved through the existing predominant IFRS practice. The member also noted that the responses confirmed that there are circumstances in which the regulatory agreement is legally enforceable and does create rights and obligations that are legally enforceable, as described in the Rate Regulation DP. As a result, the project should move forward using defined rate regulation as its basis for developing proposals for an accounting model, instead of repeating discussions about the description.

48. Another ASAF member agreed that scope is crucial but also considered that the Rate Regulation DP provides a good starting point so the discussion should move on to focus on possible accounting models. However, the member also noted that when considering scope, care should be taken to avoid a ‘cliff edge’ effect if entities may drop out of scope. He suggested that maybe a disclosure-only approach may be safer.

49. One ASAF member acknowledged concerns about the need for the regulatory agreement to be enforceable in order for the financial effects to be reflected in the financial statements.

The member confirmed that in his jurisdiction there is a track record of enforcement of both the rights and obligations established by the regulatory agreement. In his view, this forms a suitably strong basis to justify the recognition of regulatory assets and regulatory liabilities. The issue is about how to identify when the rights and obligations created by the regulatory agreement should be recognised as assets and liabilities.

50. One ASAF member noted the risk that, in his jurisdiction, the rate-regulated entity and the rate regulator are often controlled by the same local government. This could create a risk that the rate-regulator and the entity may be able to use the rate-regulatory mechanisms to engage in earnings management.

51. One ASAF member noted that the likelihood of recovery of any regulatory assets recognised needs to be considered carefully in developing any model. Many of the objections raised against recognising regulatory assets seem to reflect concerns about the ability to recover amounts, particularly when dealing with longer-term items that will be included in the revenue requirement over several periods. Some members noted the risk that demand may decrease in the future and it may become harder to increase prices sufficiently to recover the amounts.

52. One ASAF member suggested that perhaps the right to recover costs that have been incurred, particularly costs related to repair of damage to the infrastructure, could be analogised to a type of 'reimbursement right'. If so, questions about the amount to be recovered relate to measurement of the reimbursement right. This might help to distinguish between reimbursement for past costs incurred, which could be recognised as a regulatory asset, versus a right to increase future prices for activities that have not yet provided a service. This issue is particularly important to consider when the revenue requirement includes amounts designed to fund activities that relate to the entity's own property, plant and equipment or other assets.

53. One ASAF member noted that, when developing an accounting model to recognise regulatory assets and regulatory liabilities, an important issue to consider is who controls the infrastructure or other assets. If the infrastructure is not controlled by the entity, then it is likely to be in the scope of IFRIC 12 *Service Concession Arrangements*. IFRIC 12 considerations are to be the subject of a separate discussion and so the member restricted her comments to situations in which the infrastructure is controlled by the entity. When determining whether to recognise an adjustment to revenue and recognise a regulatory asset or regulatory liability, it is important to consider what is meant by a 'revenue generating activity'.

54. In the example of repairing infrastructure that is on the statement of financial positon of the entity, the member's view is that the repair work is not a revenue-generating activity in itself. However, it is part of the overall activities that the entity needs to perform in order to deliver its services to customers during the period. The revenue requirement considers the estimates of the costs of all the activities needed to deliver services. If the entity incurs costs in carrying out those activities that would have been included in the revenue requirement if they could have been foreseen or better estimated when the regulated rate was set, those recoverable amounts form part of the consideration for the services that have been provided during the period. Consequently, adjustments that relate to variances between estimated and actual

amounts should be recognised as regulatory assets or regulatory liabilities, with no asymmetry of treatment.

Clarifications to IFRS 15—*Revenue from Contracts with Customers*

55. The IASB staff provided an overview of the Exposure Draft Clarifications to IFRS 15, and asked the ASAF members:

    (a) to comment on the high hurdle applied by the IASB when considering whether and how to amend IFRS 15; and

    (b) to provide their preliminary views on the questions in the 'Invitation to comment' section of the ED.

56. ASAF members broadly supported the high hurdle applied by the IASB. They agreed with the IASB's approach of proposing amendments to IFRS 15 only when (a) those proposed amendments are essential to clarifying the Boards' intentions when developing the requirements in the Standard; or (b) when the benefits of retaining convergence with the US equivalent Topic 606, *Revenue from Contracts with Customers*, are considered greater than any potential costs of amending the Standard.

57. Some ASAF members highlighted the importance of retaining convergence between IFRS 15 and Topic 606. They also suggested that, if the amendments to be made by each Board are not the same, it is important to explain in the Basis for Conclusions when the Boards expect the outcomes of applying the differing requirements to be the same and when the outcomes could be different. If the FASB decides to further amend Topic 606, some members suggested that it would be helpful for IFRS stakeholders if the IASB were to explain whether and when those amendments cause differences in outcomes between IFRS 15 and Topic 606.

58. In relation to the specific questions in the ED, one member suggested that the IASB should consider amending IFRS 15 to exempt entities from identifying promised goods or services that are immaterial within the context of the contract. Another member thought that the indicators of control within the guidance on principal versus agent considerations could be articulated to focus on both aspects of control, ie the ability to direct the use of an asset and the ability to obtain substantially all of the remaining benefits from the asset.

Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value

59. ASAF members were asked to provide their views on the relevance of the proposed measurement model included in the Exposure Draft (ED) *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value.* The ED proposed that the fair value measurement of investments in subsidiaries, associates and joint ventures that are quoted in an active market (quoted investments) and the recoverable amount of cash-generating units (CGUs) measured on the basis of fair value less costs of disposal (FVLCD) when they correspond to entities that are quoted in an active market (quoted CGUs) should be based on the product of the quoted price for the individual financial instruments that make up the investment (P) and the quantity of financial instruments (Q), ie P × Q.

60. An ASAF member, although not responding to the question, commented that investments below the significant influence threshold are a common area where the P × Q measurement is questioned when applied.

Quoted investments in subsidiaries, joint ventures and associates

61. ASAF members were asked how frequently investment entities have investments in subsidiaries that are quoted. ASAF members noted that it was rare for investment entities to have quoted investments in subsidiaries.

62. One ASAF member commented that they had conducted outreach with investment funds in their region and noted that the results from the outreach indicated that it was not very frequent for investment entities to have quoted investment in subsidiaries. However, in the instances in which they are quoted, the impact of the proposals could be significant.

63. Another ASAF member commented that it is not common for investment entities to have investments in quoted subsidiaries, but that it may occur when an investor takes a public company private and keeps a small percentage of the shareholding outstanding as part of a structuring opportunity.

64. In relation to how frequently non-investment entities have investments in subsidiaries, joint ventures and associates that are quoted and are measured at fair value in the parent's separate financial statements, some ASAF members commented that for non-investment entities this was not a common situation. However, when those investments are quoted and measured at fair value in the investor's separate financial statements, the impact of the proposals could be significant.

65. Other ASAF members commented that for non-investment entities, it is less frequent to have investments measured at fair value because such entities mainly use a cost measurement in their separate financial statements.

66. One ASAF member commented that entities in their jurisdiction are required to publish IFRS-compliant financial reports only for consolidated financial statements and not for separate financial statements.

67. In relation to the question on how frequently do venture capital organisations, mutual funds, unit trusts and similar entities have investments in joint ventures and associates that are quoted and measured at fair value in the investor's consolidated and separate financial statements, a few ASAF members commented that this circumstance was rare.

68. One ASAF member noted that valuation specialists may be of the view that the price paid for a stake might not equate to the amount derived by P x Q but suggested that this was more of a theoretical issue. In this regard, this ASAF member commented that if the issue was not significant in practice, then entities would be comfortable applying P x Q.

69. One ASAF member commented that listed associates are not typically accounted for at fair value in the separate financial statements of the investor. This ASAF member commented

that under IFRS 12 *Disclosure of Interests in Other Entities*, entities are required to disclose the fair value of listed associates and the feedback received is that most entities use P × Q when providing these disclosures. On this point, it was noted that entities are comfortable using P × Q and that the difference between the acquisition price and the value derived by P × Q may not be particularly material and may not have a significant impact.

70. One ASAF member pointed out that if an entity that is a private equity or a venture capital organisation purchased a private entity, and the exit plan for that private entity is to have an initial public offering (IPO), then it could be very challenging to change the measurement basis through that process. In these instances, the entity does not use P × Q for measuring the fair value of those quoted investments.

71. In relation to the question on how relevant the fair value measurement of quoted investments is on the basis of P × Q, ASAF members noted:

    (a) some of their constituents thought that P × Q resulted in a relevant measurement, while others were concerned about the alignment of the fair value measurement with the unit of account.

    (b) P × Q is not relevant, because it is not consistent with the unit of account being the investment as a whole.

    (c) P × Q was reliable, highly irrelevant and not consistent with the definition of fair value.

    (d) P × Q was irrelevant, because the price of one share cannot be used to measure a large shareholding.

    (e) P × Q is a relevant fair value measurement for quoted investments because they are generally not transferred to a third party on an aggregated basis; however, in instances in which quoted investments are disposed of as a block, the fair value measurement should be determined by applying a valuation technique or by adjusting Level 1 prices. This member also commented that investments in subsidiaries, joint ventures and associates should be measured at historical cost in the separate financial statements, irrespective of whether they are quoted or not. This is because fair value is not a relevant measurement in these instances, because the investments are held for the purpose of generating cash flows in the ordinary course of business.

    (f) investors with whom that ASAF member had conducted outreach supported P × Q. This was a clear message received from investors; not because it was relevant but because they had difficulty in relying on a different measurement.

    (g) the relevance of P × Q depends on the size of the control premium, ie if the control premium was relatively small then P × Q as a measurement model would be more relevant.

(h) P × Q is not very relevant and that assessing quoted prices in an active market was the biggest issue. For quoted investments, especially in emerging markets, quoted prices depend on liquidity and therefore there will not always be a Level 1 price available.

(i) the fair value measurement for quoted investments should be consistent with the requirements of IFRS 13 *Fair Value Measurement*. This ASAF member noted that the acquisition of quoted investments is not always valued at P × Q and other factors that reflect the characteristics of the investment should be considered; for example, if there is a limitation on the sale of the stake then this factor should be reflected in the fair value measurement.

(j) the measurement resulting from applying P × Q is objective but only for one day. This member noted that markets are volatile and that P × Q is only a point-in-time measurement.

72. ASAF members were asked for their advice on:

(a) When valuation techniques are used, what are the main inputs used in deriving the fair value measurement?

(b) How relevant/predominant is the inclusion of premiums and/or discounts in those measurements?

(c) How well substantiated are they?

73. One ASAF member commented that some of the main inputs include rights being conveyed to the holder. This member noted that it is not merely control premiums that are factored in, but that other items such as blockage rights, additional information rights and voting rights should be considered in the fair value measurements.

74. This ASAF member noted that it is difficult to assign a specific valuation technique, because the measurement methodology is driven by the nature of the investment and the jurisdiction in which the transactions for that investment occurs. That member further noted that control premiums are highly relevant, but that the manner in which they are derived is very subjective.

75. One ASAF member noted that when valuation techniques are applied when measuring quoted investments at fair value, P × Q is often adjusted to reflect the control premium. This ASAF member also noted that P × Q is also used without adjustments, because of due to cost-benefit considerations (the calculations was quick and easy to perform).

76. Another ASAF member noted that a discounted cash flow method was applied in that member's jurisdiction for quoted investments to reflect rights and restrictions associated with the shareholding—this was the case even when a Level 1 price was available. They noted that for regulatory purposes, the quoted price is required to be disclosed.

77. In relation to CGUs and how relevant P x Q is, one ASAF member noted that there may be an increase in impairments if P × Q is the required measurement when determining the

recoverable amount using Fair Value Less Cost of Disposal (FVLCD). This ASAF member commented that entities would be motivated to obtain a higher recoverable amount if P × Q resulted in an impairment being recorded.

78. Regarding whether the measurement of the recoverable amount of quoted CGUs on the basis of FVLCD using P × Q would be relevant, one ASAF member commented that the relevance depended on the closeness of the alignment between the CGU and the quoted entity. This ASAF member also mentioned that the ED proposals would result in a lack of alignment between the measurement of the recoverable amount on the basis of FVLCD for quoted and unquoted CGUs. One ASAF member commented that P × Q would introduce market volatility into the impairment calculation. This ASAF member further noted a survey that outlined that most companies in Europe use FVLCD when determining the recoverable amount of a CGU instead of value in use.

79. There was little support from ASAF members regarding the recommendations made by respondents to the ED to use a rebuttable presumption. In these members' view, entities would, in most cases, rebut the P × Q presumption and assert that a measurement derived using a valuation technique would more faithfully represent fair value.

80. One ASAF member noted that a rebuttable presumption is not viable and that P × Q is the most simple and commonly used measurement in their jurisdiction. This ASAF member noted that market participants have a wide range of views on what the premium or discount should be. Hence, even if these premiums or discounts were allowed, they would ignore the premiums or discounts embedded in the valuation of these quoted investments and apply their own premium or discount to the valuation.

81. Some ASAF members supported a recommendation to measure the fair value of the quoted investments by applying a valuation technique and disclosing the measurement derived by applying P × Q together with a reconciliation between the two measurements. However, one member noted that P × Q would be a viable solution from a cost-benefit perspective.

82. One ASAF member commented that it would be difficult to reconcile a Level 3 fair value measurement obtained by applying a valuation technique to the measurement obtained by applying P × Q, but that disclosing a quoted price would not be challenging.

Pollutant pricing mechanisms (formerly emissions trading schemes)

83. At this meeting, the ASAF members considered a possible model to account for a cap-and-trade type of emissions trading scheme (ETS) that reflected the feedback received from ASAF members in the July 2015 meeting. Agenda Paper 5 (AP5) outlined the possible model and asked ASAF members to comment on issues about how to account for the 'Day 1 credit balance' that arises as a result of the entity receiving allocated allowances from the government for nil consideration.

84. Most ASAF members acknowledge that the allocated allowances provide an 'economic hedge' against the cost of the scheme. The IASB staff confirmed that references to an 'effective hedge' in AP5 were not intended to suggest that the hedge accounting requirements in IFRS 9 *Financial Instruments* should apply. ASAF members noted their understanding that the intention was to reflect how well the allowances held covered the cost of obtaining sufficient allowances to remit to the government and suggested that the phrase 'economic hedge' was appropriate to convey this meaning.

85. Some ASAF members expressed concerns, some of which had been previously expressed in the July meeting, about recognising the allocated allowances received as assets, because the entity was not able to benefit from the full value of the allowances received. Instead, some ASAF members suggested using the number of allocated allowances as a 'benchmark' level. Any possible accounting model should, therefore, focus only on amounts above or below that benchmark level.

86. However, many members reaffirmed the view that they had expressed in the July meeting; which is that the allocated allowances are an economic resource controlled by the entity and, as a result, the allocated allowances should be recognised initially at fair value. They noted that the fact that the allowances may be needed to settle the entity's obligation to remit allowances as a result of emitting during the period does not stop them from meeting the definition of an asset, nor does it mean that they fail the recognition criteria in the *Conceptual Framework* ED.

87. Some ASAF members commented that the entity can use the allowances in different ways to obtain value from them. As a result, the allowances should be reported separately in the financial statements, because failing to recognise the allowances in the statement of financial position could hamper transparency and reduce the relevance of the financial information provided.

88. All ASAF members reaffirmed the view that they expressed in the July meeting, which is that recognising a 'Day 1 gain' in the income statement would not faithfully represent the economics of the emission trading schemes. This is because they understand that only existing emitters will receive allocated allowances at nil consideration and that the receipt of the allocated allowances is not a 'free meal' that provides an 'unconditional' benefit. Most ASAF members acknowledge that a cap-and-trade ETS is expected to impose a cost on the participants that will increase over time, unless the entity takes action to reduce its level of emissions.

89. As a result, those ASAF members that agreed that the allocated allowances should initially be recognised as assets at fair value agreed that the resulting 'Day 1 credit balance' should be recognised in the statement of financial position. However, they expressed mixed views about how to describe that credit balance within the context of the proposed definition of a 'liability' in the Exposure Draft *Conceptual Framework for Financial Reporting*, published in May 2015 ('the *Conceptual Framework* ED').

90. Some ASAF members questioned whether the receipt of the allocated allowances was sufficient to establish the extent of the entity's obligation in order to satisfy the wording in paragraph 4.31(b) of the *Conceptual Framework* ED, because the entity may end up remitting more or fewer allowances than the amount allocated.

91. One ASAF member suggested that it could be reasonable to assume that the entity will need to return the full amount and, therefore, the entity should recognise a Day 1 liability at the same amount as the allocated allowances, which should themselves be recognised as assets. If the entity could demonstrate that it would be able to retain some of the allowances because it expects to emit fewer emissions, then it could release some of the liability and recognise a gain. ASAF members then discussed when it would be appropriate to recognise such a gain, without reaching a view. The staff noted that this is a question to be discussed at a later time.

92. Another ASAF member noted that it might be helpful to consider the issue as two separate liabilities—one to return allocated allowances and another to remit allowances to cover the emissions made. The IASB staff agreed that this might be helpful and added that there are three components to consider:

(a) a 'loan' component, which reflects the requirement for the entity to return the allocated allowances unless it can reduce its emissions;

(b) a 'grant' component, for the amount of any possible 'release' from the return component in cases in which the entity can reduce its emissions below the level of allocated allowances received; and

(c) an 'excess emissions' component, for the liability that arises if the entity makes more emissions than it receives allocated allowances for.

93. Agenda Paper 5 highlights possible ways to address these components and highlights advantages and disadvantages of different possible approaches. The paper highlights that different approaches create different issues and the IASB staff are seeking advice from ASAF members about how to balance the issues in order to move forward with developing a viable accounting model.

94. One ASAF member suggested that perhaps the Day 1 credit balance could be viewed as a form of 'performance obligation'. As noted earlier, the allocation of the allowances is not unconditional. The entity must either reduce its emissions in order to retain the allowances or, if it fails to reduce its emissions, it must return the allowances. This approach, it was suggested, might enable any possible model to be applied to other types of schemes in which an entity earns allowances by reducing emissions or by capturing pollutants through forestry or other activities.

95. Some ASAF members suggested that treating the Day 1 credit balance as a performance obligation could raise more questions about how to measure the liability.

96. One ASAF member suggested than an alternative approach could be to use a model similar to the ‘cash flow hedge accounting’ model currently used for financial instruments.

The Equity Method of Accounting

97. In this session, the FASB briefly outlined its simplification project on the equity method of accounting, which includes eliminating the requirement for an entity to measure at fair value its share of the investee's identifiable assets and liabilities. Currently, the FASB is analysing the comment letters received on its ED.

98. The IASB staff sought the views of the ASAF's members on the IASB staff's preliminary proposals to amend the equity method of accounting. Those proposals include the elimination of the requirement for an entity to measure at fair value its share of the investee's identifiable assets and elimination the requirement to adjust for the entity's share of gains and losses from 'upstream' and 'downstream' transactions.

99. Generally the ASAF members did not support the approach outlined in the agenda paper and noted the following reasons:
    (a) The preliminary proposals would move away from the traditional view that the equity method is a one-line consolidation method. Given the application of the equity method as a one-line consolidation concept over the past 30 years, the equity method should not be revised radically.
    (b) The preliminary proposals seem to have moved far away from the original objective of this project, which was to address application issues relating IAS 28.
    (c) The preliminary proposals could have a significant impact on financial performance.
    (d) Simplification itself should not be the object of this project.

100. One ASAF member noted that because the preliminary proposals move away from the one-line consolidation concept, it is important to consider application of the methodology for jointly controlled entities.

101. Some ASAF members suggested that the project should consider whether the equity method of accounting is appropriate for all investments where an investor has significant influence or joint control and that alternative accounting should be considered. One ASAF member agreed with the idea of simplification of the equity method and noted that it is debatable whether the requirements of IAS 28 are uniformly applied. That member also recommended considering the need for uniform accounting policy between investor and investee and the meaning of earnings numbers produced by using the staff's preliminary proposals.

102. One ASAF member suggested focussing on current application issues with IAS 28 rather than revising the methodology itself. They considered this might be achieved in a shorter time scale than revising the methodology.

103. Some ASAF members expressed a preference to undertake a long-term project, stating a concern that the conceptual basis of the short-term project could be reversed in a long-term project. They noted that a longer-term project should also consider goodwill impairment.

104. The IASB Vice-Chair asked ASAF members to reflect their opinions relating to the prioritisation of the equity method of accounting project in their responses to the Agenda Consultation.

IASB project update including Insurance Contracts

Insurance contracts Update

105. The IASB staff provided an overview of the recent IASB's tentative discussions on the insurance contracts project, which focussed on:

   (a) requirements for insurance contracts with participation features; and

   (b) the different effective dates of IFRS 9 *Financial Instruments*.

Insurance contracts with participation features.

106. Insurance contracts with participation features are contracts that include additional payments paid to the policyholder that arise differently to the payments that are commensurate with the insurance loss.

107. The ASAF members received a verbal update on the IASB's tentative decisions on the accounting for insurance contacts with participation features:

   (a) the disaggregation in the statement of comprehensive income of the changes in an insurance contract arising from changes in market variables. The IASB tentatively decided that the objective when disaggregating the changes between profit or loss and other comprehensive income (OCI) is that the insurance investment expense in profit or loss should be reported on a cost measurement basis. Accordingly, the difference between the insurance investment expense reported in profit or loss and the expense determined on a current basis is reported in OCI. A consequence of a cost measurement basis in profit or loss is that accounting mismatches with the items held are likely to arise. Accordingly, the IASB tentatively decided:

      i. to extend the accounting policy choice to present an insurance investment expense using a current measurement basis in profit or loss to include contracts with participating features. Consequently, that accounting policy choice is available to all contracts accounted for in the forthcoming insurance contracts Standard; and

      ii. to modify that objective for contracts when there are no economic mismatches arising with items held (ie apply the current period book yield); and

   (b) when there are accounting consequences of mitigating risks related to insurance contracts. The IASB tentatively decided to allow an entity to recognise changes in the value of the embedded guarantee in the insurance liability in profit or loss. The changes are measured using fulfilment cash flows and are subject to specified conditions to ensure that an economic offset exists.

108. No questions or further comments were provided by ASAF members.

The different effective dates of IFRS 9 and the new insurance contracts Standard.

109. ASAF members received an update of the IASB's tentative decisions at the recent IASB's September 2015 meeting:

   (a) Deliberations were completed on the package of proposed temporary measures to address the additional temporary accounting consequences that might arise from applying the IFRS 9 before the new insurance contracts Standard comes into effect. The package of proposed temporary measures, if confirmed, would amend IFRS 4 *Insurance Contracts* (IFRS 4):

      i. to permit a reporting entity whose activities are predominantly insurance a temporary exemption from applying IFRS 9 until 2021 ('the Deferral Approach'); and

      ii. to give entities issuing insurance contracts that implement IFRS 9 the option to remove from profit or loss some of the accounting mismatches and temporary volatility that could occur before the new insurance contracts Standard is implemented ('the Overlay Approach').

   (b) the due process steps that the IASB has taken in developing an Exposure Draft (ED) of Amendments to IFRS 4 were reviewed. IASB members confirmed that they are satisfied that the IASB has completed the necessary due process steps on the project to date and therefore instructed the staff to commence the balloting process for the ED. The IASB expects to publish the ED in December 2015.

110. The following comments were made on the forthcoming ED:

   (a) Two ASAF members agreed that a shortened comment period was appropriate.

   (b) One ASAF member agreed with the urgency of the proposals but noted that that urgency should not prejudge the IASB's consideration of the due process for the finalisation of the new insurance contracts Standard.

   (c) One ASAF member noted preparers in their jurisdiction are unlikely to apply the Overlay and Deferral approaches. Instead, those preparers support the reassessment of the business model and the options for financial assets on the transition to the new insurance contracts Standard. Accordingly, the IASB's decisions on those transition reliefs should be highlighted in the Basis for Conclusions in the forthcoming ED.

   (d) One ASAF member suggested that the IASB's reason for the Deferral Approach at the reporting entity level, instead of below the reporting entity level, should be discussed in the Basis for Conclusions in the forthcoming ED.

   (e) Two ASAF members noted their concerns on which reporting entities would qualify for the Deferral Approach:

      i. A large insurer would not qualify for the Deferral Approach in the group's consolidated financial statements because its parent is a bank.

      ii. Some banking subsidiaries of an insurer could qualify for the Deferral Approach in the consolidated financial statements.

      iii. The accounting treatment of an associate that applied the Deferral Approach in its individual separate financial statements, when that associate was consolidated in a group's of financial statements that did not apply the Deferral Approach.

111. IASB members and staff present noted:

(a) that the Deferral Approach will be proposed in combination with the Overlay Approach and the Deferral Approach would apply to a limited range of entities subject to a predominance test;

(b) the Deferral Approach reduces the lack of comparability for financial instruments and this would be the case no matter which entities were deemed to qualify.

(c) the Deferral Approach at the reporting entity level would mean that the financial instruments of the group are reported using either IFRS 9 or IAS 39. It avoids the lack of comparability in the group's financial statements of financial instruments reported using both IFRS 9 and IAS 39; and

(d) any issues arising from the Deferral Approach will be limited to three years, because of the proposed approach expiry date of 2021.

Project Update

112. The IASB staff presented an overview of the IASB's current projects, a summary of the actions taken on the advice provided by the ASAF in previous meetings and the suggested agenda topics for the December 2015 and April 2016 meetings.

113. Members made the following comments regarding the agenda proposals:

(a) The AASB proposed presenting a paper being developed jointly with the Korea Accounting Standards Board on The Impact of Cultural Differences on the Implementation of IFRS.

(b) The ASBJ noted it would like to present a paper on Recognition, as part of the debate on the Conceptual Framework.

(c) The GLASS representative noted that he would like to bring back to the ASAF meeting a paper, which is being further developed by GLASS, on Inflation Accounting. It was agreed that this paper should be presented in April 2016.