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**Date**      **7-8 February 2019**


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**Location**    **IASB, Boardroom,**  
 Columbus Building | 7 Westferry Circus |  
 Canary Wharf | London E14 4HD | UK

# AGENDA [24/01/2019]

*Agenda timings or topics may change as the meeting progresses. To receive real-time updates, follow us on [Twitter](#) at [@IFRSFoundation](#) using the hashtag [#IFRSMeetings](#).*

## Thursday 7 February

Time UK	Agenda item	Agenda ref.
09.30-10.00	<b>SME Standard review and update</b>	30
10.00-10.30	<b>Management Commentary</b>	Oral Update
10.30-12.00	<b>Primary Financial Statements</b>	21
12.00 – 13.00	<b>Lunch</b>	
13.00-14.30	<b>Primary Financial Statements [Contd.]</b>	21
14.30-14.45	<b>Break</b>	
14.45-16.45	<b>Amendments to IFRS 17 <i>Insurance Contracts</i></b>	2

## AGENDA [24/01/2019]

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**Friday 8 February**

Time UK	Agenda item	Agenda ref.
09.30- 11.30	<b>IBOR Reform and the Effects on Financial Reporting</b>	14

## STAFF PAPER

February 2019

IASB<sup>®</sup> meeting

<b>Project</b>	<b>Amendments to IFRS 17 <i>Insurance Contracts</i></b>		
<b>Paper topic</b>	Loans that transfer significant insurance risk		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS<sup>®</sup> Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB<sup>®</sup> *Update*.

**Purpose**

1. This paper discusses loans that transfer significant insurance risk. IFRS 17 *Insurance Contracts* requires entities to account for some of those contracts as insurance contracts in their entirety.

**Summary of staff recommendations**

2. The staff recommend the International Accounting Standards Board (Board) amend the scope of IFRS 17 and IFRS 9 *Financial Instruments* for insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract. The amendment would enable entities issuing such contracts to account for those contracts applying either IFRS 17 or IFRS 9. Such an amendment to the scope of IFRS 9 would require consequential amendments to IFRS 7 *Financial Instruments: Disclosures* and IAS 32 *Financial Instruments: Presentation*.

## Structure of the paper

3. This paper provides:
  - (a) an overview of the requirements in IFRS 17 and a summary of the Board's rationale for setting those requirements, including an overview of the Board's previous discussions (paragraphs 4–14 of this paper);
  - (b) an overview of the concerns and implementation challenges expressed since IFRS 17 was issued (paragraphs 15–18 of this paper); and
  - (c) the staff analysis, recommendations and questions for Board members (paragraphs 19–44 of this paper).

## IFRS 17 requirements and the Board's rationale

### **Scope of IFRS 17**

4. IFRS 17 applies to all insurance contracts as defined in IFRS 17, regardless of the type of entity issuing the contracts, with some specific exceptions. The definition of an insurance contract in IFRS 17 is the same as the definition of an insurance contract in IFRS 4 *Insurance Contracts*, with minor clarifications to the related guidance in Appendix B of IFRS 4.<sup>1</sup>
5. The Board decided that IFRS 17 should apply to all entities issuing insurance contracts—as opposed to insurers only—because:
  - (a) if an insurer that issues an insurance contract accounted for that contract in one way and a non-insurer that issues the same insurance contract accounted for that contract in a different way, comparability across entities would be reduced;
  - (b) entities that might meet the definition of an insurer frequently have major activities in other areas as well as in insurance and would need to

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<sup>1</sup> The clarifications in IFRS 17 require that: (i) an entity should consider the time value of money in assessing whether the additional benefits payable in any scenario are significant; and (ii) a contract does not transfer significant insurance risk if there is no scenario with commercial substance in which the entity can suffer a loss on a present value basis.

determine how and to what extent these non-insurance activities would be accounted for in a manner similar to insurance activities or in a manner similar to how other entities account for their non-insurance activities; and

- (c) a robust definition of an insurer that could be applied consistently from jurisdiction to jurisdiction would be difficult to create.

6. IFRS 17 carries forward from IFRS 4 some scope exclusions. Paragraph 7 of IFRS 17 excludes from the scope of the Standard various items that may meet the definition of insurance contracts, such as:

- (a) warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer. IFRS 15 *Revenue from Contracts with Customers* applies to those warranties. The Board noted that, if IFRS 17 were to apply to such warranties, entities would generally apply the premium allocation approach to such contracts, which would result in accounting similar to that which would result from applying IFRS 15. Further, in the Board’s view, accounting for such contracts in the same way as other contracts with customers would provide comparable information for the users of financial statements for the entities that issue such contracts. Hence, the Board concluded that changing the existing accounting for these contracts would impose costs and disruption for no significant benefit.
- (b) some financial guarantee contracts. An entity shall not apply IFRS 17 to financial guarantee contracts it issues unless it has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts. The Board decided to carry forward from IFRS 4 the option that permits an issuer of a financial guarantee contract to apply IFRS 9 or IFRS 17 to such contracts, without any substantive changes, because the option has worked in practice and results in consistent accounting for economically similar contracts issued by the same entity.
- (c) the following contracts because they are in scope of other IFRS Standards:

- (i) employers' assets and liabilities that arise from employee benefit plans (see IAS 19 *Employee Benefits* and IFRS 2 *Share-based Payment*);
- (ii) retirement benefit obligations reported by defined benefit retirement plans (see IAS 26 *Accounting and Reporting by Retirement Benefit Plans*);
- (iii) contractual rights or contractual obligations contingent on the future use of, or the right to use, a non-financial item (see IFRS 15, IAS 38 *Intangible Assets* and IFRS 16 *Leases*);
- (iv) residual value guarantees provided by the manufacturer, dealer or retailer and lessees' residual value guarantees embedded in a lease (see IFRS 15 and IFRS 16); and
- (v) contingent consideration payable or receivable in a business combination (see IFRS 3 *Business Combinations*).

7. Paragraph 8 of IFRS 17 also allows an entity a choice of applying IFRS 17 or IFRS 15 to some fixed-fee service contracts. Some stakeholders noted some entities issue both fixed-fee service contracts and other insurance contracts. For example, some entities issue both roadside assistance contracts and insurance contracts for damage arising from accidents. The Board decided to allow entities a choice of whether to apply IFRS 17 or IFRS 15 to fixed-fee service contracts to enable such entities to account for both types of contract in the same way.

8. IFRS 17 was developed with the objective that entities provide relevant information in a way that faithfully represents the features of all types of insurance contracts. IFRS 17 reflects the Board's view that:

- (a) an insurance contract combines features of both a financial instrument and a service contract in such a way that those components are interrelated; and
- (b) many insurance contracts generate cash flows with substantial variability over a long period.

9. To provide useful information about these features, the Board developed the approach in IFRS 17 which:
  - (a) combines current measurement of the future cash flows with the recognition of profit over the period services are provided under the contract—measuring insurance contracts at current value is consistent with the requirements for comparable financial instruments; and
  - (b) presents insurance service results (including presentation of insurance revenue) separately from insurance finance income or expenses.
  
10. As explained in paragraphs BC7–BC11 of the Basis for Conclusions on IFRS 17 the Board considered whether an entity could apply generally applicable IFRS Standards to the insurance contracts it issues. The Board concluded that applying generally applicable IFRS Standards would provide useful information for users of financial statements and would be relatively easy to apply to insurance contracts for which there is no significant variability in outcomes and no significant investment component. However, simply applying generally applicable Standards would be difficult and would produce information of limited relevance for other types of insurance contracts.

### ***Separating components from an insurance contract***

11. For insurance contracts that include non-insurance components IFRS 17 requires an entity to:
  - (a) apply IFRS 9 to determine whether there is an embedded derivative to be separated from a host insurance contract and, if there is, to determine how to account for that derivative;
  - (b) account for any distinct investment component separately from a host insurance contract applying IFRS 9;
  - (c) account for any promise to transfer distinct goods or non-insurance services separately from a host insurance contract applying IFRS 15; and

- (d) apply IFRS 17 to all remaining components of the host insurance contract—these components include embedded derivatives that are not separated, non-distinct investment components and promises to transfer non-distinct goods or non-insurance services.
12. IFRS 17 prohibits the separation of non-insurance components from an insurance contract if the specified criteria are not met. IFRS 17 is more restrictive in this regard than IFRS 4.
  13. The Board decided to prohibit an entity from separating a non-insurance component when not required to do so by IFRS 17 because:
    - (a) it would be difficult for an entity to routinely separate components of an insurance contract in a non-arbitrary way and setting requirements to do so would result in complexity; and
    - (b) such separation would ignore interdependencies between components, with the result that the sum of the values of the components may not always equal the value of the contract as a whole, even on initial recognition.
  14. Therefore, the Board concluded that permitting separation of non-distinct non-insurance components would result in less useful information and reduce the comparability of the financial statements across entities.

### **Concerns and implementation challenges expressed since IFRS 17 was issued**

15. Some stakeholders are concerned that IFRS 17 requires entities to account for some loans that transfer significant insurance risk as insurance contracts in their entirety. Examples of those contracts provided by stakeholders are the following:
  - (a) mortgage with death waiver contract—the contract includes the following features:
    - (i) the contract is a retail mortgage with life insurance coverage—the consideration for the life insurance coverage is part of the overall interest rate charged on the mortgage; and

- (ii) the outstanding balance of the mortgage is waived if the borrower dies.
  - (b) student loan contract—the contract includes the following features:
    - (i) the contract is a loan made to students to fund their tertiary education under the terms of a government scheme;
    - (ii) the loan bears a specified interest rate but interest is paid only if a repayment trigger is met; and
    - (iii) repayments are income contingent (for example, a percentage of earnings over an annual threshold) and may not be made at all if the borrower’s income never exceeds the repayment threshold or the borrower dies.
  - (c) lifetime mortgage contract (sometimes called equity release or reverse mortgage contract)—the contract includes the following features:
    - (i) the contract is a retail mortgage that an entity offers to older customers;
    - (ii) when the customer dies or moves into long-term care, the property is sold and the proceeds are used to repay the mortgage balance (including any accrued but unpaid interest). The following scenarios may arise:
      1. the property is sold for more than the mortgage balance and the excess is paid to the customer;
      2. the property is sold for less than the mortgage balance and the loss is borne by the entity.
16. Those contracts:
- (a) typically combine a loan with an agreement from the entity to compensate the borrower if a specified uncertain future event adversely affects the borrower (for example, death) by waiving some or all the payments due under the contract (for example, repayment of the loan balance and payment of interest). Although the definition of an insurance contract in IFRS 17 is the same as the definition in IFRS 4, some stakeholders observed that the requirements in IFRS 17 for the separation of non-insurance components (such as a loan component) differ from the

requirements in IFRS 4, which permit entities to separate a loan component from an insurance contract and apply IFRS 9 to the loan component.

- (b) may not have the legal form of an insurance contract.
- (c) are generally issued by non-insurance entities, which might be expected to be in a less advanced stage of IFRS 17 implementation and might not have fully assessed the implications of the changes introduced by IFRS 17 to the requirements for the separation of non-insurance components discussed in paragraph 16(a) of this paper.

17. Some stakeholders:

- (a) are concerned that entities issuing those contracts have not been preparing to apply IFRS 17 to such contracts in their entirety—some of those stakeholders expressed the view that the requirement to apply IFRS 17 to those contracts in their entirety would impose unnecessary costs to non-insurance entities because, for example, those entities would need to develop systems to calculate the risk adjustment and the contractual service margin applying the general model, and would need to educate their investor community on the changes introduced by IFRS 17 to their financial reporting.
- (b) believe that it would be more appropriate to account for those contracts partially or totally applying IFRS 9 because such contracts expose the entity mainly to credit risk. Those stakeholders noted that credit risk would be reflected in measurement if the entity were to apply IFRS 9 to those contracts. Those stakeholders also stated that if an entity were to account for those contracts at fair value through profit or loss applying IFRS 9:
  - (i) changes in non-financial assumptions would be recognised immediately in profit or loss as fair value changes (rather than recognised against the contractual service margin if the entity were to apply IFRS 17 and the changes relate to future service);

- (ii) the entity would present the contract profit as part of the financial result (rather than as part of the insurance service result if the entity were to apply IFRS 17); and
- (iii) the measurement of those contracts would be consistent with how some entities measure loan contracts that do not include any insurance component.

18. Those stakeholders have suggested the following alternative amendments to IFRS 17 that they think would address their concerns:

- (a) amend the requirements for the separation of non-insurance components in IFRS 17 so that an entity is permitted or required to separate a loan component from an insurance contract and to account for the loan component applying IFRS 9. This amendment would require that an entity applies IFRS 17 only to the remaining component of the host insurance contract.
- (b) expand the scope exclusions in paragraph 7 of IFRS 17 (see paragraph 6 of this paper) so that an entity is not required to apply IFRS 17 to loans that transfer significant insurance risk (referred to as ‘insurance contracts that have credit risk as their main risk to the issuer’ by some stakeholders). This amendment could require or permit an entity to apply IFRS 9 to those contracts.

## Staff analysis and recommendation

19. The staff note that:

- (a) a contract that is an insurance contract applying IFRS 4 is expected to be an insurance contract applying IFRS 17 (and vice versa). The clarifications provided by IFRS 17 about the definition of an insurance contract in IFRS 4—mentioned in paragraph 4 of this paper—are not expected to change conclusions about whether contracts are insurance contracts.
- (b) some loan contracts meet the definition of an insurance contract applying IFRS 4 and IFRS 17. Paragraph B26 of IFRS 17 provides examples of

contracts that are insurance contracts if the transfer of insurance risk is significant that are similar to the contracts described in paragraph 15 of this paper, including life insurance and prepaid funeral plans (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur within the period covered by the insurance) (see paragraph B26(c) of IFRS 17). The Guidance on Implementing IFRS 4 includes as an example of an insurance contract a loan contract that waives repayment of the entire loan balance if the borrower dies.

- (c) applying IFRS 4, loan contracts that transfer significant insurance risk are regarded as containing a deposit component (the loan)<sup>2</sup> and an insurance component (for example, the waiver of the loan balance on death, equivalent to a cash death benefit). If specified conditions are met, an entity would:
  - (i) account separately for insurance and non-insurance components in those contracts; and
  - (ii) apply IFRS 9 to measure the loan embedded in those contracts.
- (d) applying IFRS 17, the loan embedded in those contracts does not meet the definition of an investment component,<sup>3</sup> nor can it be accounted for separately. Therefore, IFRS 17 requires an entity to apply IFRS 17 to those contracts in their entirety.

20. The staff note that, although the three examples of loan contracts discussed in paragraph 15 of this paper have different features, all of these contracts are insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract—ie the obligation of the policyholder/borrower to pay the loan and its accrued interest.

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<sup>2</sup> IFRS 4 defines a deposit component as ‘a contractual component that is not accounted for as a derivative under IFRS 9 and would be within the scope of IFRS 9 if it were a separate instrument’.

<sup>3</sup> IFRS 17 defines an investment component as ‘the amounts that an insurance contract requires the entity to *repay* to a policyholder even if an insured event does not occur’ [emphasis added].

21. Consistent with the Board’s rationale discussed in paragraphs 8–9 of this paper, the staff think that the IFRS 17 model appropriately reflects:
- (a) the variability in outcomes of insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract. Estimates of cash flows are based on current information at the end of every reporting period.
  - (b) the credit risk to which the entity is exposed in issuing those contracts. The measurement of a group of insurance contracts applying IFRS 17 includes an estimate of the expected present value of the cash flows generated by the contracts. The expected present value is the probability-weighted mean of the present value of the possible cash flows, discounted using current estimates of discount rates. The measurement model in IFRS 17 therefore reflects the risk of non-payment of the loan by policyholders.
  - (c) the profit earned over the period services are provided under those contracts (ie the contractual service margin). For the examples of loan contracts discussed in paragraph 15 of this paper the insurance coverage is always for the same period of the loan balance because the insurance is over the settlement of that balance—the coverage period ends when the loan balance is repaid. Therefore, the staff think that any service is provided in the same pattern as the insurance coverage.
22. However, the staff think that:
- (a) there might be significant costs to implement IFRS 17, without corresponding benefits, for entities that do not issue insurance contracts other than insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract.<sup>4</sup> As discussed in paragraph 34 of this paper, the staff think that applying IFRS 9 to such contracts would also provide useful information to users of financial statements.

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<sup>4</sup> The staff note this situation is different from insurance contracts that include an investment component. The insurance coverage in such contracts is not related to the recovery of the investment component.

(b) some entities, for example those that are in a less advanced stage of IFRS 17 implementation or those that do not typically issue other contracts within the scope of IFRS 17 and thus are not focused on IFRS 17 implementation, might not have fully assessed the implications of the changes introduced by IFRS 17 to the requirements for the separation of non-insurance components from the insurance contracts they issue (see paragraphs 19(c)–(d) of this paper).

23. Accordingly, the staff have considered possible ways of amending IFRS 17 to address the problems discussed in paragraph 22 of this paper and ease IFRS 17 implementation for those entities. The staff have analysed the following approaches suggested by stakeholders (see paragraph 18 of this paper):

- (a) Approach 1—Separating the loan from an insurance contract.
- (b) Approach 2—Excluding from the scope of IFRS 17 insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract:
  - (i) Approach 2A—A requirement that entities exclude from the scope of IFRS 17 such contracts; and
  - (ii) Approach 2B—An option that permits entities to apply either IFRS 17 or IFRS 9 to such contracts.

### ***Approach 1—Separating the loan from an insurance contract***

24. As discussed in paragraph 12 of this paper, IFRS 17 prohibits the separation of non-insurance components from an insurance contract if the specified criteria are not met. A loan embedded in the contracts described in paragraph 15 of this paper cannot be assessed for separation from an insurance contract applying paragraph 10–13 of IFRS 17 because the loan does not meet the definition of an embedded derivative, an investment component, a good or a non-insurance service (see paragraph 11 of this paper).

25. Thus, separating the loan component from the insurance contract would require the Board to amend IFRS 17 to enable an entity to account for the loan applying

IFRS 9 and the insurance component applying IFRS 17. This approach would extend the requirements for separating non-insurance components from an insurance contract discussed in paragraph 11 of this paper. For some entities, this would represent a continuation from existing accounting practice for some loans that transfer significant insurance risk.

26. The staff note that the loan component and the insurance component in a contract that compensates the borrower—by waiving some or all the payments due under the contract—if a specified uncertain future event adversely affects the borrower are highly interrelated because:

- (a) the value of the compensation (waiver) varies accordingly to the outstanding balance of the loan; and
- (b) the full repayment of the loan causes the lapse of the waiver.

27. The staff observe that separating loans from an insurance contract can improve comparability when separation can be achieved without arbitrary allocations. Accounting for loans using IFRS 9 might:

- (a) make them more comparable to similar contracts that are issued as separate contracts; and
- (b) allow users of financial statements to better compare the risks undertaken by entities in different businesses or industries.

28. However, there are also limitations to the usefulness of separating components. Separating a contract into components could result in complex accounting that does not provide useful information if the contract contains interdependent cash flows that are not attributable to individual components. As noted in paragraph 13 of this paper:

- (a) when cash flows are interdependent, separating the cash flows for each component can be arbitrary, particularly if the contract includes cross-subsidies between components or discounts; and
- (b) when separation ignores interdependencies between components, the sum of the values of the components may not always equal the value of the contract as a whole, even on initial recognition.

29. The staff think that:
- (a) the reasons for which the Board decided to limit the circumstances in which an entity separates non-insurance components from an insurance contract—discussed in paragraphs 13–14 of this paper—are still valid.
  - (b) amending the requirements for separating components from an insurance contract in IFRS 17 would:
    - (i) be complex;
    - (ii) may not result in useful information for the separated components; and
    - (iii) represent a significant change to the requirements in IFRS 17 that might significantly disrupt implementation processes that are already under way.
30. The staff therefore do not recommend amending IFRS 17 to add requirements for the separation of loans from an insurance contract.

***Approach 2—Excluding from the scope of IFRS 17 insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract***

31. As discussed in paragraph 6 of this paper, IFRS 17 excludes from the scope of the Standard various items that may meet the definition of insurance contracts. The Board decided to substantially carry forward the scope exclusions from IFRS 4. When developing the scope of IFRS 4 and IFRS 17, the Board decided that the transfer of significant insurance risk is the unique feature of an insurance contract. The Board did not consider it appropriate to exclude from the scope of IFRS 17 contracts with non-insurance components that are the predominant portion of the overall contract. In the Board’s view, if a contract transfers significant insurance risk, the contract is an insurance contract. The presence of non-insurance components, no matter how substantial, does not change the insurance risk assumed by the entity.

33. As discussed in paragraph 18(b) of this paper, some stakeholders have suggested the Board amend IFRS 17 to exclude from the scope of the Standard loans that transfer significant insurance risk. Such an amendment could require or permit an entity to apply IFRS 9 in recognising and measuring those contracts in their entirety.

*Approach 2A—Require entities to apply IFRS 9 to insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract*

34. The staff think that applying IFRS 9 to the examples of loan contracts discussed in paragraph 15 of this paper, which would be captured by the possible scope exclusion, would provide useful information to users of financial statements, for example through the measurement of the contracts at fair value through profit or loss.
35. However, the staff note that amending IFRS 17 to require entities to apply IFRS 9 to insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract might introduce a significant change for entities that currently account for those contracts applying IFRS 4 and are preparing to implement IFRS 17. Some entities might need to develop systems to account for contracts with insurance and non-insurance components in accordance with IFRS 9, while already developing systems to implement IFRS 17 to account for those contracts.
36. The staff note that those contracts meet the definition of an insurance contract because they transfer significant insurance risk. IFRS 17 was developed with the objective that entities issuing contracts that transfer significant insurance risk faithfully represent those contracts. As discussed in paragraph 21 of this paper, the staff think that the IFRS 17 model appropriately reflects the feature of these contracts and therefore do not believe that it would be appropriate to prohibit an entity issuing those contracts from accounting for them applying IFRS 17. In addition, prohibiting entities from applying IFRS 17 to those contracts would not enable entities that issue those contracts and other types of insurance contracts to account for both types of contract in the same way.

37. The staff therefore do not recommend requiring IFRS 9 for accounting for insurance contracts for which the only insurance in the contract is for the settlement of some or all the obligation created by the contract.

*Approach 2B—Option to apply either IFRS 17 or IFRS 9 to insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract*

38. The staff think that amending IFRS 17 to permit entities to apply IFRS 9 to insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract would avoid the problem identified in paragraph 35 of this paper and would ease IFRS 17 implementation for some entities. Consistently with the existing scope exclusions in IFRS 17 for financial guarantee contracts (see paragraph 7(e) of IFRS 17) and for fixed-fee service contracts (see paragraph 8 of IFRS 17), the staff think that an entity should be permitted to make a choice contract by contract, rather than for all the insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract that the entity issue. However, the choice for each contract should be irrevocable.

39. The staff note that allowing an entity a choice, on a contract-by-contract basis, of whether to apply IFRS 17 or IFRS 9 to such contracts would enable:

- (a) an entity that mainly issues insurance contracts to apply IFRS 17 to insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract, permitting comparability with the other insurance contracts issued by the same entity; and
- (b) an entity that mainly issues financial instruments to apply IFRS 9 to insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract, permitting comparability with the financial instruments issued by the same entity, without imposing IFRS 17 implementation costs for such contracts to the entity. As some entities issuing such contracts may not otherwise be applying IFRS 17 the staff note that this may be particularly helpful in minimising the risk of disruption to implementation.

40. The staff considered whether to recommend that some entities be required to apply IFRS 17 to insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract and other entities to apply IFRS 9 to such contracts, for example depending on the extent to which they apply IFRS 17 to other contracts. However, the staff concluded that such a requirement would not address the concerns and implementation challenges discussed in paragraphs 15–18 of this paper because it would still require insurance entities to account for some loans that transfer significant insurance risk as insurance contracts in their entirety.
41. The staff think that amending IFRS 17 to permit an entity to apply IFRS 17 or IFRS 9 to a specified population of insurance contracts—ie insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract—would address the concerns and implementation challenges discussed in paragraphs 15–18 of this paper without unduly impairing comparability. This is because, entities that would elect to apply IFRS 9 to those contracts would account for those contracts in the same way as other financial instruments and would therefore provide useful information about those contracts, similarly to entities that would apply IFRS 17 instead.
42. The staff therefore think that Approach 2B in this paper would meet the criteria set by the Board at its October 2018 meeting because it would not:
- (a) result in a significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements; or
  - (b) unduly disrupt implementation processes that are already under way—many loans that transfer significant insurance risk are issued by non-insurance entities that may be at a less advanced stage of IFRS 17 implementation.
43. Accordingly, the staff recommend the Board amend the scope of IFRS 17 and IFRS 9 for insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract, by adding a scope exclusion in IFRS 17 so that an entity may apply either IFRS 17 or IAS 32, IFRS 7 and IFRS 9 to such contracts that it issues.

44. Such amendment to the scope of IFRS 9 would require consequential amendments to IFRS 7 and IAS 32. The staff note that if the Board were to amend IFRS 17 to permit an entity to apply IFRS 9 to those contracts the staff will consider possible implications to the transition and disclosures requirements at a future Board meeting.

**Question for Board members**

Do you agree the Board amend the scope of IFRS 17 and IFRS 9 for insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract to enable an entity to apply either IFRS 17 or IFRS 9 to such contracts that it issues?

## STAFF PAPER

February 2019

## IASB® meeting

Project	Amendments to IFRS 17 <i>Insurance Contracts</i>		
Paper topic	Transition—Risk mitigation option and amounts accumulated in other comprehensive income on transition		
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**Purpose**

1. This paper considers stakeholder feedback about the requirements in IFRS 17 *Insurance Contracts* relating to the prohibition of retrospective application of the risk mitigation option and the determination of the cumulative amount of insurance finance income or expenses recognised in other comprehensive income (OCI) on transition.

**Summary of staff recommendations**

2. The staff recommend the International Accounting Standards Board (Board):
  - (a) retain the requirements in IFRS 17 relating to the prohibition of retrospective application of the risk mitigation option on transition to IFRS 17; and
  - (b) retain the requirements in IFRS 17 with respect to the cumulative amounts included in other comprehensive income on transition to IFRS 17.

## Structure of the paper

3. This paper discusses the following topics:
  - (a) the prohibition of retrospective application of the risk mitigation option; and
  - (b) the determination of the cumulative amount of insurance finance income or expenses recognised in OCI on transition.
4. For each topic, this paper provides:
  - (a) an overview of the requirements in IFRS 17;
  - (b) a summary of the Board’s rationale for setting those requirements, including an overview of the Board’s previous discussions;
  - (c) an overview of the concerns and implementation challenges expressed since IFRS 17 was issued; and
  - (d) the staff analysis, recommendations and questions for Board members.

## Prohibition of retrospective application of the risk mitigation option

### ***IFRS 17 requirements and Board’s rationale***

5. IFRS 17 applies to insurance contracts and IFRS 9 *Financial Instruments* applies to financial assets and derivatives held by the entity. Accounting mismatches can arise because those Standards measure insurance contracts differently from financial assets and derivatives. In particular, the measurement of insurance contracts applying the variable fee approach results in the effects of changes in financial assumptions adjusting the contractual service margin of the group of insurance contracts, while the effect of those changes on financial assets and derivatives is recognised in profit or loss or other comprehensive income.
6. During the development of IFRS 17, the Board noted that entities may purchase derivatives to mitigate risks of changes in financial assumptions. An accounting mismatch arises because:

- (a) the change in the fair value of the derivative would be recognised in profit or loss applying IFRS 9; but
  - (b) the change in the insurance contract, the risk of which was mitigated by the derivative, would adjust the contractual service margin applying IFRS 17, unless the contracts were onerous.
7. Hence, the Board included in IFRS 17 an option for the entity in specified circumstances to recognise the effect of some changes in financial risk in the insurance contracts in profit or loss, instead of adjusting the contractual service margin.
8. This risk mitigation option is permitted if:
- (a) an entity has a previously documented risk-management objective and strategy for using derivatives<sup>1</sup> to mitigate financial risk arising from the insurance contracts;
  - (b) in applying that objective and strategy it uses a derivative to mitigate the financial risk arising from the insurance contracts;
  - (c) an economic offset exists between the insurance contracts and the derivative, ie the values of the insurance contracts and the derivative generally move in opposite directions because they respond in a similar way to the changes in the risk being mitigated; and
  - (d) credit risk does not dominate the economic offset.
9. Paragraph BC393 of the Basis for Conclusions on IFRS 17 explains that the documentation requirement is analogous to the documentation requirements for hedge accounting in IFRS 9. Consistent with the transition requirements for hedge accounting in IFRS 9, the Board concluded that retrospective application of the risk mitigation treatment would give rise to the risk of hindsight. In particular, the Board was concerned that because the application of the approach is optional, entities could choose the risk mitigation relationships to which it would apply with the benefit of

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<sup>1</sup> In January 2019, the Board tentatively decided to amend IFRS 17 to expand the scope of the risk mitigation exception so that the exception applies when an entity uses a derivative or a reinsurance contract held to mitigate financial risk.

knowing at transition how that relationship had developed. Consequently, IFRS 17, consistent with the transition requirements for hedge accounting in IFRS 9, requires prospective application of the risk mitigation option from the date of initial application of the Standard.

***Concerns and implementation challenges expressed since IFRS 17 was issued***

10. Consistent with the feedback during the development of IFRS 17, some stakeholders continue to be concerned that the risk mitigation exception in IFRS 17 can only be used prospectively even though risk mitigation activities may have been in place before the date of initial application of IFRS 17. Given that the contractual service margin will be allocated to profit or loss in future periods, those stakeholders are concerned a contractual service margin that does not reflect risk mitigation activities from previous periods may distort:
  - (a) the equity of entities on transition—because the effect of previous changes in the fair value of the derivatives will be included in the equity on transition, while the corresponding effect on the insurance contracts will be included in the measurement of the insurance contracts; and
  - (b) the revenue recognised for these groups of contracts in future periods—because the contractual service margin includes the changes in financial risks that would have been excluded had the risk mitigation option been applied retrospectively.
  
11. Some stakeholders suggested the Board should amend the transition requirements of IFRS 17 in one of the following ways:
  - (a) allow entities to apply the risk mitigation option fully retrospectively, or prospectively from the transition date<sup>2</sup> rather the date of initial application;
  - (b) allow entities to apply the risk mitigation option retrospectively provided that they can demonstrate that they had a previously documented risk-management

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<sup>2</sup> For the purposes of the transition requirements in IFRS 17: (a) the date of initial application is the beginning of the annual reporting period in which an entity first applies IFRS 17; and (b) the transition date is the beginning of the annual reporting period immediately preceding the date of initial application.

objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts; or

- (c) an approach similar to the one proposed by paragraph 11(b) of this paper, except that the entity would be required to apply the risk mitigation option for all circumstances that a previously documented risk-management objective and strategy exist (ie an ‘all or nothing’ approach).

### **Staff analysis and recommendation**

12. The staff observe that the risk mitigation option is by nature prospective because:
  - (a) it can only be applied after an entity has a documented risk-management objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts;
  - (b) once the entity determines the fulfilment cash flows in a group to which the risk mitigation option applies, it applies this determination in a consistent manner in each future reporting period; and
  - (c) if any of the conditions for applying the risk mitigation option cease to be met, the entity ceases using the option without making any adjustments for changes previously recognised in profit or loss.
  
13. The staff think that applying the risk mitigation option retrospectively without using hindsight is challenging. The entity would have to determine what amounts it would have recognised in profit or loss for the mitigated risks. The staff also think that retrospectively applying *an option* that is prospective by nature gives rise to ‘cherry picking’ opportunities. Retrospective application of the risk mitigation option could also lead to unjustified inconsistency with the requirements for hedge accounting in IFRS 9 that prohibits the retrospective application of hedge accounting for the same reason.
  
14. To illustrate, if the Board were to permit the risk mitigation option to be applied retrospectively, entities that have a previously documented risk-management objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts could, for example:

- (a) choose retrospectively the risk mitigation relationships to which they apply the option based on the outcome known at the effective date;
  - (b) determine the fulfilment cash flows in a group to which the risk mitigation option applies retrospectively based on the outcome known at the effective date; and
  - (c) determine when to start applying the risk mitigation option based on the outcome known at the effective date, even if the derivative had the same risk mitigating effect in previous periods.
15. The staff think that a benefit of an option that is prospective by nature is that it reflects management decisions in the most neutral way—at the point in time an entity makes a decision to apply a risk mitigation option not knowing what will be its outcome, and therefore provides the most useful information to users of financial statements about this decision and its consequences over time. While a retrospective application that would not use hindsight may also provide useful information to users of financial statements about risk mitigation activities that took place in previous periods, it is hard to see how the option could be applied retrospectively without the use of hindsight, and the use of hindsight would significantly reduce the value of this information. The staff observe that any of the proposed approaches described in paragraph 11 of this paper may have this effect.
16. The staff acknowledge that the equity and future profitability reported by entities would be different if they had been able to apply the risk mitigation option retrospectively. However, the staff note that allowing entities to choose to which relationships to apply the risk mitigation option with the benefit of hindsight effectively enables entities to choose the amount of the contractual service margin on transition and thus the future profit to be recognised in profit or loss.<sup>3</sup>
17. The staff also note that IFRS 9 allows entities on initial application to designate financial assets as measured at fair value through profit or loss when doing so mitigates an accounting mismatch (fair value option), and that IFRS 17 allows entities

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<sup>3</sup> Some suggest the ‘all or nothing’ approach in paragraph 11(c) of this paper could avoid the use of hindsight and resulting cherry picking. However, the staff observe that, in the absence of required documentation for existing financial reporting purposes, it could be difficult to ensure that the information used is complete and valid.

to make that designation on first applying IFRS 17 to the same extent as they could on first applying IFRS 9. That designation of financial assets under the fair value option is made on the basis of the facts and circumstances that exist at the date of initial application and the measurement is applied retrospectively. The staff considered whether allowing retrospective application of the risk mitigation option in IFRS 17 could be justified as being similar to the retrospective application of the measurement under the IFRS 9 fair value option.

18. The staff concluded that retrospective application of the risk mitigation option differs from the retrospective measurement under the IFRS 9 fair value option because although the designation at fair value is optional (assuming the relevant criterion is met at the date of initial application), once that choice is made, there is no choice about how the resulting measurement applies retrospectively. In contrast, retrospective application of the risk mitigation option would require entities to decide what risk mitigation relationships the option would have applied to in previous periods and the extent of the risk mitigation covered by the option.
  
19. The staff therefore think that an amendment to IFRS 17 to permit retrospective application of the risk mitigation option would cause significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements. Accordingly, the staff recommend that the Board retain the requirements in IFRS 17 relating to the prohibition of retrospective application of the risk mitigation option.

**Question 1 for Board members**

Do you agree that the Board should retain the requirements in IFRS 17 relating to the prohibition of retrospective application of the risk mitigation option on transition to IFRS 17?

## Determination of the cumulative amount of insurance finance income or expenses recognised in other comprehensive income on transition

### *IFRS 17 requirements*

20. When an entity chooses to disaggregate insurance finance income or expenses between profit or loss and OCI, it may be permitted or required to determine the cumulative amount of insurance finance income or expenses recognised in OCI at the transition date as nil in the following circumstances:<sup>4</sup>
- (a) permitted when applying the fair value approach (paragraph C24(b) of IFRS 17);
  - (b) permitted when applying the modified retrospective approach for groups of insurance contracts that include contracts issued more than one year apart (paragraph C18(b) of IFRS 17); and
  - (c) required when applying the modified retrospective approach for groups of insurance contracts that do not include contracts issued more than one year apart for insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to the policyholders (paragraph C19(b)(ii) of IFRS 17).<sup>5</sup>
21. An entity is permitted to apply the specified modifications included in paragraphs 20(b) or 20(c) of this paper only to the extent that an entity does not have reasonable and supportable information to apply a retrospective approach.
22. When an entity applies any of the requirements included in paragraph 20 of this paper, it is required to disclose a reconciliation from the opening to the closing balance of the cumulative amounts included in other comprehensive income for financial assets measured at fair value through other comprehensive income related to these groups of insurance contracts, for all periods in which amounts determined applying these

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<sup>4</sup> Except for insurance contracts with direct participation features for which the entity holds the underlying items.

<sup>5</sup> On the basis that the assumptions that relate to financial risk that applied at the date of initial recognition are those that applied on transition date. Applying the discount rate at the transition date for determining insurance finance income or expenses presented in the statement of profit or loss is the same as assuming that accumulated other comprehensive income is nil in respect of the relevant contracts.

requirements exist. The reconciliation includes for example, gains and losses recognised in other comprehensive income in the period and gains or losses previously recognised in other comprehensive income in previous periods reclassified in the period to profit or loss.

### **Board's rationale**

23. When setting the transition requirements discussed in paragraph 20 of this paper the Board decided to provide a simplified approach to determine the cumulative amount of the insurance finance income or expenses recognised in OCI at transition when an entity chooses to disaggregate the insurance finance income or expenses between profit or loss and OCI—by permitting or requiring this amount to be nil.
24. The effect of setting the cumulative amount recognised in OCI at nil compared to a retrospective approach depends on the difference between interest rates when the contracts were written and interest rates at transition:
  - (a) if transition interest rates are lower than interest rates when the contracts were written, the cumulative amount recognised in OCI applying the IFRS 17 requirements retrospectively would be a debit balance, resulting in a higher insurance finance expense in reporting periods after transition compared to an approach that set the cumulative amount recognised in OCI at nil; and
  - (b) if transition interest rates are higher than interest rates when the contracts were written, the cumulative amount recognised in OCI applying the IFRS 17 requirements retrospectively would be a credit balance, resulting in a lower insurance finance expense in reporting periods after transition compared to an approach that set the cumulative amount recognised in OCI at nil.
25. The Board noted that these effects on the insurance finance expense will combine with the investment income from financial assets held by the entity to give an investment margin. The Board observed that users of financial statements need to understand the effect of transition on the investment margin. Therefore, for contracts that determine a cumulative amount recognised in OCI on transition, the Board decided to require entities to disclose a reconciliation from the opening to the closing

balance of the cumulative amounts included in other comprehensive income for related financial assets measured at fair value through other comprehensive income (FVOCI).

***Concerns and implementation challenges expressed since IFRS 17 was issued***

26. Some stakeholders raise concerns that the outcome of applying the transition requirements of IFRS 17, as described in paragraph 20 of this paper, would result in determining the accumulated amount of insurance finance income or expenses recognised in OCI as nil, while the amount accumulated in OCI for the related assets would not be nil. They think this effect could significantly distort equity on transition to IFRS 17 and on the investment margin reported in profit or loss in future periods, until the related assets are no longer held. The Board had noted similar concerns when setting these requirements as discussed in paragraphs 24–25 of this paper.
27. Some stakeholders have suggested the Board should amend the requirements of IFRS 17<sup>6</sup> to either:
  - (a) permit an entity to deem the accumulated amount of finance income in OCI related to related assets as nil at transition to IFRS 17; or
  - (b) permit an entity to deem the accumulated amount of insurance finance income or expenses in OCI for these insurance contracts at the same amount as the accumulated amount of finance income in OCI on the related assets at transition.
28. Given that the assets are not held as underlying items for insurance contracts with direct participation features, and may therefore not be clearly identified with the insurance contracts, some stakeholders suggest that the related assets should be identified consistently with the entity’s existing asset liability management policies and practices. If the entity’s existing asset liability management policies and practices do not provide an indication of which assets are related to the relevant insurance

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<sup>6</sup> Or IFRS 9.

contracts, those stakeholders suggest an entity should allocate a pro-rata part of the general account assets to the relevant insurance contracts.

### **Staff analysis and recommendation**

29. IFRS 17 provides entities with a choice about whether to disaggregate insurance finance income or expenses between profit or loss and OCI. An entity is not required to apply this choice and can make this choice for portfolios of insurance contracts considering for each portfolio of contracts the assets that the entity holds and how it accounts for them. The staff observe that an entity can consider the outcome discussed in paragraphs 24–25 of this paper when making this policy choice.
30. Permitting entities to deem the cumulative amount in OCI related to corresponding assets as nil at transition to IFRS 17, as suggested in paragraph 27(a) of this paper, would involve an amendment to IFRS 9. The staff think this makes the transition requirements in IFRS 9 more complicated, and would significantly reduce the comparability of information related to the financial assets held between (a) insurers applying that amendment and (b) entities other than insurers and insurers that do not apply the amendment.
31. The staff also observe that a component of the cumulative amount recognised in OCI applying IFRS 9 for FVOCI financial assets relates to expected credit losses. Hence it would not be possible to set that component of the cumulative amount at nil because of the effect on the accounting in future periods for expected credit losses.
32. Permitting entities to deem the cumulative amount of insurance finance income or expenses recognised in OCI for insurance contracts at transition at the same amount as the cumulative amount in OCI relating to related assets, as suggested in paragraph 27(b) of this paper, would affect the insurance finance income or expense that will be recognised in future reporting periods. The insurance finance income or expense recognised in profit or loss in future periods would reflect the historical discount rate for the assets held at transition date that the entity determines to be related to the

insurance contracts.<sup>7</sup> The staff think that this suggested approach would reduce the usefulness of information provided on the performance of the insurance contracts because:

- (a) that information will be affected by the assets an entity holds so may significantly reduce comparability between entities issuing similar contracts but holding different assets; and
- (b) of the potential subjectivity involved in determining which assets relate to which insurance contracts.

33. The staff consider that the disclosure requirements discussed in paragraph 22 of this paper are adequate to provide useful information to users of financial statements on the related assets,<sup>8</sup> and therefore recommend that the Board should not amend IFRS 17 with respect to the cumulative amounts included in other comprehensive income.

**Question 2 for Board members**

Do you agree that the Board should retain the requirements in IFRS 17 with respect to the cumulative amounts included in other comprehensive income on transition to IFRS 17?

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<sup>7</sup> This is because the amount recognised in the OCI cumulatively over the duration of the groups of contracts is required to total zero.

<sup>8</sup> The staff will discuss in a future Board paper whether this disclosure should be extended to cover the insurance finance income or expenses of such contracts.

## STAFF PAPER

February 2019

IASB® Meeting

Project	IBOR Reform and its Effects on Financial Reporting		
Paper topic	Issues leading up to IBOR reform		
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## Introduction

1. At its December 2018 meeting, the Board decided to add to its standard-setting programme the *IBOR Reform and its Effects on Financial Reporting* project to assess the effects on financial reporting of the potential discontinuation of IBOR. Following the discussion around the staff research findings at the December 2018 Board meeting, the purpose of this paper is to present the staff analysis and the proposed amendments to IFRS Standards for specific issues affecting financial reporting leading up to IBOR reform.
2. This paper is structured as follows:
  - (a) Summary of staff recommendations (paragraph 3);
  - (b) Background (paragraphs 4 – 12);
  - (c) Highly probable requirement (paragraphs 13 – 35);
  - (d) Prospective assessments (paragraphs 36 – 61);
  - (e) Risk components (paragraphs 62 – 94);
  - (f) End of the proposed relief (paragraphs 95 – 104);
  - (g) Disclosures (paragraphs 105 – 108);
  - (h) Effective date (paragraphs 109 – 112); and

- (i) High-level project timeline (paragraphs 113 – 115).

### Summary of staff recommendations

3. In this paper the staff recommend that:

- (a) IFRS 9 and IAS 39 should be amended to provide relief from the effects of IBOR reform uncertainties on the highly probable requirement;
- (b) IAS 39 and IFRS 9 should be amended to provide relief from the effects of IBOR reform uncertainties on the prospective assessments<sup>1</sup>;
- (c) the Board should not amend the hedge accounting model in IFRS 9 and IAS 39 to provide relief for designation of risk components that are not separately identifiable;
- (d) entities should stop applying the proposed relief when the earlier of the following occurs: i) the designated IBOR financial instrument is contractually amended to replace IBOR for the alternative RFR; or ii) the hedging relationship terminates. In addition, entities are not permitted to apply the proposed relief for hedging relationships designated after the RFR is separately identifiable;
- (e) entities should provide specific disclosures about the extent to which they are applying the proposed relief; and
- (f) entities should apply the proposed amendments retrospectively. The proposed effective date of the amendments is 1 January 2020 with earlier application permitted.

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<sup>1</sup> In this paper, the requirements in paragraph 6.4.1(c)(i) of IFRS 9 (ie the existence of an economic relationship) and paragraph AG105(a) of IAS 39 (ie whether the hedge is expected to be highly effective) are collectively referred to as ‘prospective assessments’.

## Background

4. As discussed at the June 2018 Board meeting, recent developments have brought into question the long-term viability of some interbank offered rates (IBOR).<sup>2</sup> In some jurisdictions, there is already a clear steer towards replacing them by alternative, nearly risk-free rates (RFR), which are based, to a higher extent, on transaction data.
5. At its December 2018 meeting, the Board decided to divide the *IBOR Reform and its Effects on Financial Reporting* project into two phases and address the issues arising in the first phase as a priority. The first phase will focus on issues affecting financial reporting leading up to IBOR reform. These issues are more urgent because they might affect financial reporting before IBOR reform is enacted. The second phase of the project will focus on issues that affect financial reporting when IBOR reform is enacted. With respect to the second-phase issues, the staff note that there is an ongoing debate about how market participants will approach some key issues related to amendment of legacy positions and whether value transfers will occur as a result. These amendments can vary significantly across jurisdictions, product types and agreements. As a result, the staff will need to monitor further developments in this area so that, as more information become available, the staff will be able to provide a comprehensive assessment of the potential implications of IBOR reform on these second-phase issues. This paper covers issues arising in the first phase of the project only.
6. At the December 2018 Board meeting, the staff noted that some areas in hedge accounting that require forward-looking analyses might be impacted by uncertainties arising from IBOR reform. These include the ‘highly probable’ requirement for forecast transactions designated as hedged items, and the existence of an economic relationship, according to *IFRS 9: Financial Instruments* (IFRS 9), or expectation that the hedge will be highly effective in achieving offsetting, as per *IAS 39: Financial Instruments: Recognition and Measurement*

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<sup>2</sup> As noted in the June 2018 Agenda Paper *Research project proposal*, interbank offered rates (IBOR) are interest rates that represent the cost of obtaining unsecured funding, in a particular combination of currency and maturity, and in a particular interbank term lending market. The most widely used of these reference rates is the London Interbank Offered Rate (LIBOR). Other examples of IBOR are the Euro Interbank Offered Rate (EURIBOR) and the Tokyo Interbank Offered Rate (TIBOR).

(IAS 39), which are, by nature, forward-looking assertions. These assertions are part of the set of qualifying criteria an entity must comply with in order to apply hedge accounting. The staff highlight that these specific forward-looking assertions do not change the actual results of a hedge and thus do not affect measurement of the hedging instrument and hedged item. Instead, these assertions reflect an entity's expectation that, going forward, the hedging relationship will meet these specific criteria to qualify for hedge accounting.

7. The proposals discussed in this paper aim to provide relief from the effects of IBOR reform uncertainties on the above forward-looking assertions required by IFRS 9 and IAS 39. As the specific conditions of IBOR reform develop and time to transition approaches, the fair value of designated hedging instruments and hedged items might be affected. This would represent the economics of such instruments that the staff think should be captured in financial reporting. Consequently, the proposals in this paper are designed accordingly. In other words, the economics of these instruments will be captured through measurement, which is not affected by the proposed relief discussed in this paper.
8. In addition, the staff note that some aspects of the IBOR reform might also impact the requirements for designation of some risk components as hedged items. These issues might affect financial reporting before IBOR reform is enacted as they could lead to discontinuation of hedge accounting and potentially preclude designation of new hedging relationships.
9. Failure to achieve or continue hedge accounting due to a major change in market structure, such as IBOR reform, was not contemplated when IFRS 9 and IAS 39 were written. In view of this, this paper provides further analysis on whether discontinuation of hedge accounting would provide useful information to users of financial statements when a hedging relationship fails the hedge accounting requirements noted in paragraph 10 due to uncertainties arising from IBOR reform.
10. In this paper, we discuss issues contemplated in the first phase of the project and recommend whether or not the Board should take any actions to address them. The discussion is segregated into the following areas in hedge accounting:
  - (a) Highly probable requirement (paragraphs 13 – 35);

- (b) Prospective assessments (paragraphs 36 – 61); and
  - (c) Risk components (paragraphs 62 – 94).
11. As the above hedge accounting issues arise in a context of a market wide reform of benchmark interest rates, this paper focuses on hedges of interest rate risk only. Consequently, the solutions proposed in this paper only apply to hedges of interest rate risk. In addition, given hedge accounting is optional, the application of the proposed relief is also optional.
12. As discussed at the December 2018 meeting, paragraph 7.2.21 of IFRS 9 states that when an entity first applies IFRS 9 it may choose to continue to apply the hedge accounting requirements of IAS 39 instead of those in IFRS 9. In addition, companies applying *IFRS 4: Insurance Contracts* and that meet certain conditions, may continue to apply IAS 39 for annual periods beginning before 1 January 2021 (or 1 January 2022 as tentatively decided by the Board at its November 2018 meeting). For these reasons, our analysis contemplates both IFRS 9 and IAS 39.

### Highly probable requirement

13. According to paragraph 6.3.3 of IFRS 9 and paragraph 88(c) of IAS 39, when a forecast transaction is designated as a hedged item in a cash flow hedge, that transaction must be highly probable. When the hedged item is designated in terms of forecast IBOR cash flows and these cash flows will occur after IBOR reform, the question that follows is whether those forecast IBOR cash flows would meet the highly probable requirement because the underlying contracts will likely be amended at some point in the future to reflect a new benchmark RFR, as discussed at the December 2018 Board meeting.
14. The staff also highlight that, to meet the highly probable requirement, paragraphs F.3.10 and F.3.11 of the Implementation Guidance of IAS 39 states that an entity should identify and document a forecast transaction with sufficient specificity so that, when the transaction occurs, the entity is able to determine whether the transaction is the hedged transaction. The same guidance would apply to hedging relationships designated under IFRS 9 (paragraph BC6.95 of the Basis for

Conclusions of IFRS 9 states that not carrying forward the Implementation Guidance of IAS 39 did not mean that the Board had rejected that guidance).

15. In practice, hedging relationships are commonly designated whereby the IBOR component of a financial instrument is documented as the hedged risk. In this context, paragraph B6.3.11 of IFRS 9 states that, when designating a risk component as a hedged item, the hedge accounting requirements apply to that risk component in the same way as they apply to other hedged items that are not risk components. Consequently, given the requirement for specificity, it might be difficult to demonstrate, at some point in the future, that the designated IBOR cash flows are highly probable given the effects from IBOR reform. The staff note that, although the words in IFRS 9 and IAS 39 may be slightly different, both standards have the same requirements in this area.
16. As per paragraph 6.3.7 of IFRS 9 and paragraph 81 of IAS 39, an entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship. Regardless of whether an entity designates the IBOR risk component of a floating-rate debt or the entire debt instrument as the hedged item, in both cases the uncertainties arising from IBOR reform could affect the highly probable requirement. Therefore, as uncertainty from IBOR reform increases and time to transition approaches, it could be argued that, at some point, these designated forecast cash flows will be no longer highly probable under IFRS 9 and IAS 39.

### *Accounting implications*

17. Paragraph 6.5.6 of IFRS 9 and paragraph 101 of IAS 39 require an entity to discontinue hedge accounting prospectively when the hedging relationship ceases to meet the qualifying criteria, one of which is the highly probable requirement. In particular, if the hedged future cash flows are no longer expected to occur, paragraph 6.5.12(b) of IFRS 9 and paragraph 101(c) of IAS 39 state that an entity should discontinue hedge accounting for a cash flow hedge, and the amount accumulated in the cash flow hedge reserve should be immediately reclassified from the cash flow hedge reserve to profit or loss. In addition, going forward, this would also result in changes in fair value of derivatives that would otherwise

qualify for hedge accounting being recognised in profit or loss (instead of the cash flow hedge reserve in Other Comprehensive Income).

18. However, a forecast transaction that is no longer highly probable may still be expected to occur. In view of this, paragraph 6.5.12(a) of IFRS 9 and paragraph 101(b) of IAS 39 state that, if the hedged future cash flows are no longer highly probable but still expected to occur, the amount accumulated in the cash flow hedge reserve should remain in the cash flow hedge reserve until the future cash flows occur. When the future cash flows occur, that amount should be reclassified from the cash flow hedge reserve to profit or loss.
19. In this context, IBOR reform might also impact reclassification of the amount accumulated in the cash flow hedge reserve related to hedging relationships that have been discontinued. For example, assume a hedging relationship was discontinued because the counterparty to the derivative (hedging instrument) experienced a severe deterioration in its credit standing, as noted in paragraph 6.4.1(c)(ii) of IFRS 9. In this scenario, the amount accumulated in the cash flow hedge reserve would be reclassified to profit or loss when the hedged item occurs (ie it is not immediately reclassified). However, assuming the hedged item in this example was designated in terms of forecast IBOR cash flows beyond IBOR reform, if those cash flows become neither highly probable nor expected to occur due to IBOR reform, the amount accumulated in the cash flow hedge reserve would be immediately reclassified to profit or loss rather than reclassified to profit or loss when the hedged item occurs.
20. In the above example, deterioration of credit standing was used to illustrate a situation of failure to meet one of the hedge accounting qualifying criteria in IFRS 9. The same rationale would apply if a hedging relationship did not meet one of the qualifying criteria in IAS 39 (eg if the hedge was not highly effective throughout the financial reporting periods for which the hedge was designated, as required in paragraph 88(e) of IAS 39).

#### *Types of hedging relationships that might be affected*

21. To assess the accounting implications and potential solutions, the staff considered the population of hedging relationships in which the highly probable requirement

might be affected by uncertainties arising from IBOR reform. In particular, we considered the following types of hedges of interest rate risk:

- (a) *Existing IBOR hedges*: these include hedges of recognised IBOR-based instruments and forecast IBOR cash flows. For the purpose of this analysis, ‘existing’ hedges refer to hedging relationships designated before or as at the effective date of any potential amendments to IFRS 9 and IAS 39;
- (b) *New IBOR hedges*: similar to item (a) above, these include hedges of recognised IBOR-based instruments and forecast IBOR cash flows. For the purpose of this analysis, ‘new’ hedges refer to relationships designated after the effective date of any potential amendments to IFRS 9 and IAS 39; and
- (c) *New RFR hedges*: these refer to hedges of forecast RFR cash flows. For the purpose of this analysis, ‘new’ hedges refer to relationships designated after the effective date of any potential amendments to IFRS 9 and IAS 39.

22. As noted in paragraph 16, failing the highly probable requirement would affect existing hedges where forecast IBOR cash flows beyond IBOR reform have been designated as the hedged item. The same applies to new IBOR hedges (ie relationships designated after the effective date of any potential amendments to IFRS 9 and IAS 39 that the Board may consider), because these relationships might also be affected by uncertainties from IBOR reform.
23. Regarding new RFR hedges, as noted in the December 2018 Board meeting, while derivative markets could have a standardised protocol enacted, if agreed by all parties, to reduce the burden of re-negotiating outstanding contracts, the process of amending legacy positions in the cash markets is yet to be determined. Therefore, it might be possible that in some jurisdictions the RFR derivative market develops before the RFR cash markets. In this context, assuming entities use RFR forward start swaps to hedge a forecast RFR debt issuance, as the specific conditions for IBOR reform affecting the forecast RFR debt instrument remain uncertain (eg whether the forecast debt instrument will bear an overnight

RFR or a 3-month RFR), these forecast RFR cash flows might fail the highly probable requirement.

### *Staff analysis*

24. As discussed at the December 2018 Board meeting, the staff think the guidance in IFRS 9 and IAS 39 provides an adequate basis to conclude an entity should discontinue hedge accounting when the designated forecasted cash flows are no longer highly probable. However, the replacement of IBOR will occur as a result of a market wide reform of benchmark RFR. More specifically, IBOR reform arises from a G20 request to the Financial Stability Board (FSB) to undertake a fundamental review of major interest rate benchmarks and develop plans for reform to ensure that these benchmarks are robust and appropriately used by market participants. Discontinuation of hedge accounting due to a major change in market structure, such as IBOR reform, was not contemplated during the development of IFRS 9 and IAS 39.
25. Failure to meet the highly probable requirement will have a significant impact on financial reporting and key accounting ratios for many IFRS preparers globally. This is because discontinuation of hedge accounting would result in reclassification of the cash flow hedge reserve to profit or loss, and derivatives that would otherwise qualify for hedge accounting purposes would be treated as trading derivatives going forward (ie measured at fair value through profit or loss).
26. The highly probable requirement ensures that changes in fair value of designated hedging instruments are recorded in the cash flow hedge reserve in Other Comprehensive Income only for those forecast transactions for which there is a high probability of occurrence. It plays an important role in ensuring the discipline around the application of hedge accounting. However, the scenario being considered, IBOR reform, is unprecedented and was not contemplated during the development of IFRS 9 and IAS 39. In this scenario, whilst interest cash flows are still going to occur, the specificity associated with these cash flows (ie whether they will be IBOR cash flows or RFR-based cash flows) is in question due to the reform. Given the accounting consequences, as outlined in paragraphs 17–19 above and the ubiquity of IBOR usage across the globe, the staff, on balance, is of

the view that the Board should consider amending IFRS 9 and IAS 39 to provide relief from the uncertainty arising from this narrow specific circumstance.

27. In view of this, the staff think it is appropriate to amend IFRS 9 and IAS 39 to provide relief from the effects of IBOR reform uncertainties on the highly probable requirement. This means that any potential amendments to the hedged item due to IBOR reform should not affect the highly probable requirement. More specifically, when assessing the likelihood that a forecast transaction will occur, an entity should consider the existing contractual terms if the highly probable assertion is based on the contractual terms of an existing contract (eg highly probable future IBOR cash flows associated with an existing floating rate liability). It should not consider possible amendments to such terms arising from IBOR reform. When the highly probable assertion is based on future transactions not recognised on the balance sheet, for example a future issuance of a floating rate debt instrument, potential amendments to the future contract due to IBOR reform should not affect the highly probable assertion for that forecast transaction. The proposed relief is optional and applies to all types of hedges of interest rate risk noted in paragraph 21 above.
28. In case the Board agrees with the staff recommendation, we think the proposed amendments to IFRS 9 and IAS 39 should clarify the Board's intention to provide relief from effects arising solely from IBOR reform uncertainties. In other words, if forecast cash flows fail the highly probable requirement due to reasons other than IBOR reform uncertainties, the proposed relief would not apply and thus those forecast cash flows would not be eligible as the hedged item in a hedging relationship under IFRS 9 and IAS 39. For example, this would be the case if a forecast transaction is considered no longer highly probable to occur due to changes in an entity's financial conditions. The staff think the proposed amendments should also make it clear that all other hedge accounting requirements must be applied as stipulated by IFRS 9 and IAS 39.<sup>3</sup>

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<sup>3</sup> The staff highlight that, in a similar situation in the past (June 2013), the Board considered the financial reporting effects arising from novations that result from new laws or regulations and decided to amend IAS 39 to provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument met certain criteria.

29. Consistent with the above, the staff would recommend that the proposed relief should also apply to hedging relationships that have been previously discontinued for reasons other than IBOR reform with an amount remaining in the cash flow hedge reserve. This is because, as noted in paragraph 19, uncertainties arising from IBOR reform might require immediate reclassification of the amount accumulated in the cash flow hedge reserve. Applying the relief would allow entities to continue reclassifying the amount accumulated in the cash flow hedge reserve to profit or loss in the same period or periods during which the hedged expected future cash flows affect profit or loss (see paragraph 6.5.11(d)(i) of IFRS 9 and paragraph 97 of IAS 39).

*Illustrative example – highly probable requirement*

30. To illustrate the application of the proposed amendments, assume an entity issues a 5-year floating-rate debt instrument, which pays interest quarterly at 3-month IBOR. The entity also enters into a 5-year interest rate swap under which it receives 3-month IBOR and pays a fixed rate of 4.0%. Assuming the relationship meets all the qualifying criteria for cash flow hedge accounting, the entity designates the forecast 3-month IBOR interest payments as the hedged item and the interest rate swap as the hedging instrument. In this scenario, the existing contractual obligation would typically support the assertion that the forecast IBOR interest payments are highly probable at inception of the hedging relationship. However, as IBOR reform approaches, there would be an increased probability that the debt instrument will be amended to reflect the alternative RFR and thus, at some point, the designated forecast IBOR interest payments would fail the highly probable requirement.
31. Applying the proposed relief would allow the entity to account for such hedging relationships as continuing relationships. In this example, because the hedging relationship would have failed the highly probable requirement solely due to uncertainties arising from IBOR reform, the entity would be able to disregard such effects when assessing the highly probable requirement until the debt instrument is amended to reflect the alternative RFR and such uncertainties are no longer present. If, for example, the entity expects to default on the debt instrument, then the entity would fail the highly probable requirement.

32. The period over which entities could apply such a relief is further discussed in paragraphs 95–104.

*Staff recommendation*

33. For the reasons stated in paragraphs 24 – 32, the staff are of the view that IFRS 9 and IAS 39 should be amended to provide relief from the effects of IBOR reform uncertainties on the highly probable requirement. This means that any potential amendments to the hedged item due to IBOR reform should not affect the highly probable requirement. More specifically, when assessing the likelihood that a forecast transaction will occur, an entity should consider the existing contractual terms of a recognised hedged item until uncertainties arising from IBOR reform are no longer present. Regarding unrecognised forecast transactions, potential amendments to underlying contracts due to IBOR reform should not affect the highly probable assertion for that forecast transaction.
34. In addition, the staff recommend that the same relief should apply to hedging relationships that have been previously discontinued for reasons other than IBOR reform with an amount remaining in the cash flow hedge reserve. Applying the relief would allow entities to continue reclassifying the amount accumulated in the cash flow hedge reserve to profit or loss in the same period or periods during which the hedged expected future cash flows affect profit or loss.
35. As noted in paragraph 6, uncertainties arising from IBOR reform might affect both the highly probable requirement and the prospective assessments required by IFRS 9 and IAS 39. Consequently, even if the Board agrees with the above staff recommendation to provide relief from the effects of IBOR reform uncertainties on the highly probable requirement, an entity could still fail the prospective assessments due to the same effects arising from IBOR reform. Hence, the staff think the decision with respect to the two requirements should be made together and accordingly this question is posed to the Board after the discussion on the prospective assessments.

## Prospective assessments

36. Prospective assessments apply to both fair value and cash flow hedges. According to paragraph 6.4.1(c)(i) of IFRS 9, a hedging relationship qualifies for hedge accounting only if there is an economic relationship between the hedged item and the hedging instrument. In this context, paragraph B6.4.4 of IFRS 9 notes that an economic relationship exists when there is an expectation that the value of the hedging instrument and the value of the hedged item will move in the opposite direction because of the same risk, which is the hedged risk.
37. A forward-looking prospective assessment is also required for hedging relationships designated under IAS 39. However, IFRS 9 and IAS 39 have different requirements around such prospective assessments. More specifically, paragraph 88(b) of IAS 39 states that a hedging relationship qualifies for hedge accounting only if ‘the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk.’ According to paragraph AG105 of IAS 39, a hedge is regarded as highly effective only if both of the following conditions are met:
- (a) At the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. Such an expectation can be demonstrated in various ways including a comparison of past changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk with past changes in the fair value or cash flows of the hedging instrument, or by demonstrating a high statistical correlation between the fair value or cash flows of the hedged item and those of the hedging instrument.
  - (b) The actual results of the hedge are within a range of 80–125 per cent.
38. These two conditions are commonly known as: i) ‘prospective test’, with reference to the fact that item (a) of paragraph AG105 requires an assessment performed on a forward-looking basis; and ii) ‘retrospective test’, given the

assessment in item (b) of paragraph AG105 is based to the actual results of the hedge. While paragraph AG105(a) of IAS 39 does not stipulate a quantitative threshold to define whether a ‘hedge is expected to be highly effective in achieving offsetting’, the staff acknowledge that practice has developed in this area and some entities might use the same range of 80-125 per cent for both assessments required in paragraph AG105 of IAS 39.

39. The effects of IBOR reform on the ‘retrospective assessment’, required by paragraph AG105(b) of IAS 39, are not considered in the staff analysis because such a retrospective assessment is based on the actual results of the hedging relationship. Disregarding the effects of IBOR reform on the actual results of a hedge could impact measurement of the hedging instrument and hedged item. This would undermine the fundamental principle in hedge accounting of offset between gains and losses on the hedging instrument and the hedged item. As noted at the December 2018 Board meeting, the staff are not considering evaluating that principle. Therefore, this paper focuses on the ‘prospective test’ required by paragraph AG105(a) of IAS 39.
40. In this paper, the requirements in paragraph 6.4.1(c)(i) of IFRS 9 (ie the existence of an economic relationship) and paragraph AG105(a) of IAS 39 (ie whether the hedge is expected to be highly effective) are collectively referred to as ‘prospective assessments’.
41. The prospective assessments provide evidence that allows an entity to make the forward-looking assertions related to the existence of an economic relationship according to IFRS 9 or expectation that the hedge will be highly effective in achieving offsetting as per IAS 39. As noted in paragraph 6, these assertions are part of the set of qualifying criteria an entity must comply with in order to apply hedge accounting. The staff highlight that these specific forward-looking assertions do not change the actual results of a hedge and thus do not affect measurement of the hedging instrument and hedged item. For example, while the prospective assessments reflect an entity’s expectation that, going forward, the hedging relationship will meet these specific criteria to qualify for hedge accounting, only the actual results of the hedge (eg changes in fair value of the hedging instrument and the hedged item in a fair value hedge) are measured and recognised in the financial statements.

42. As discussed at the December 2018 Board meeting, demonstrating the existence of an economic relationship according to IFRS 9 or expectation that the hedge will be highly effective in achieving offsetting as per IAS 39 would require the estimation of future cash flows because both assessments are prospective in nature. For those hedging relationships going beyond the expected replacement of IBOR, as time to transition approaches, the prospective assessments could be affected as they are performed on a forward-looking basis, and potentially result in discontinuation of hedge accounting.

### *Accounting implications*

43. When an entity fails the prospective assessments, paragraph 6.5.6 of IFRS 9 and paragraphs 91(b) and 101(b) of IAS 39 require the entity to discontinue hedge accounting prospectively. The consequences of prospective discontinuation of hedge accounting are:
- (a) Regarding fair value hedges, the fair value hedge adjustment will be amortised to profit or loss. The amortisation is based on a recalculated effective interest rate at the date amortisation begins;<sup>4</sup> and
  - (b) As for cash flow hedges, the accumulated amount in the cash flow hedge reserve will be reclassified to profit or loss when the hedged cash flows occur.<sup>5</sup>
44. In addition, while entities might re-designate the same derivatives in new hedging relationships, it is likely that these derivatives could fail the prospective assessments again due to the same reason. As a result, changes in fair value of derivatives previously designated in any cash flow hedges would start being recognised in profit or loss (instead of the cash flow hedge reserve in Other Comprehensive Income). Regarding derivatives previously designated in fair value hedges, offsetting would not be achieved in profit or loss because the hedged item would no longer be measured at fair value.

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<sup>4</sup> Refer to paragraph 6.5.10 of IFRS 9 and paragraphs 91-92 of IAS 39.

<sup>5</sup> Refer to paragraph 6.5.12 of IFRS 9 and paragraph 101(b) of IAS 39.

*Types of hedging relationships that might be affected*

45. As discussed in paragraph 21, to assess the accounting implications and potential solutions, the staff considered the population of hedging relationships that might be affected by uncertainties arising from IBOR reform. Considering the prospective assessments apply to both fair value and cash flow hedges, the following hedges of interest rate risk might be affected:
- (a) *Existing IBOR hedges*: these include hedges of recognised IBOR-based instruments and forecast IBOR cash flows. For the purpose of this analysis, ‘existing’ hedges refer to hedging relationships designated before or as at the effective date of any potential amendments to IFRS 9 and IAS 39;
  - (b) *New IBOR hedges*: similar to item (a) above, these include hedges of recognised IBOR-based instruments and forecast IBOR cash flows. For the purpose of this analysis, ‘new’ hedges refer to relationships designated after the effective date of any potential amendments to IFRS 9 and IAS 39; and
  - (c) *New RFR hedges*: these refer to hedges of forecast RFR cash flows. For the purpose of this analysis, ‘new’ hedges refer to relationships designated after the effective date of any potential amendments to IFRS 9 and IAS 39.
46. Failure to meet the prospective assessments would affect existing IBOR hedges because it might be difficult for entities to demonstrate the existence of an economic relationship under IFRS 9, or the expectation that the hedge will be highly effective in achieving offsetting as per IAS 39, in a scenario where the specific conditions for IBOR reform have not been determined yet. The same applies to new IBOR hedges (ie relationships designated after the effective date of any potential amendments to IFRS 9 and IAS 39 that the Board may consider), because the uncertainties arising from IBOR reform might also affect the prospective assessments of these hedges.
47. Regarding new RFR hedges, as noted in the December 2018 Board meeting, while derivative markets could have a standardised protocol enacted, if agreed by all parties, to reduce the burden of re-negotiating outstanding contracts, the process

of amending legacy positions in the cash markets is yet to be determined. Therefore, it might be possible that in some jurisdictions the RFR derivative market develops before the RFR cash markets. In this context, assuming entities use RFR forward start swaps to hedge a forecast RFR debt issuance, as the specific conditions for IBOR reform affecting the forecast debt instrument remain uncertain (eg whether the forecast debt instrument will bear an overnight RFR or a 3-month RFR), it might be difficult for entities to demonstrate the existence of an economic relationship under IFRS 9, or expectation that the hedge will be highly effective in achieving offsetting as per IAS 39.

### *Staff analysis*

48. The prospective assessments play an important role in ensuring the discipline around the application of hedge accounting. However, the scenario being considered, IBOR reform, is unprecedented and was not contemplated during the development of IFRS 9 and IAS 39. Therefore, for the same reasons expressed in paragraphs 24 – 29 and given the accounting consequences outlined in paragraphs 43 – 44, the staff, on balance, is of the view that the Board should consider amending IFRS 9 and IAS 39 to provide relief from the effects of IBOR reform uncertainties on the prospective assessments.
49. As discussed in paragraph 37, the words in IFRS 9 and IAS 39 are different and thus the following analysis considers the proposed relief for each standard separately.
50. Regarding IAS 39, paragraph AG105(a) states that entities can demonstrate whether the hedge is expected to be highly effective in achieving offsetting by comparing changes in fair value or cash flows of the hedged item with changes in fair value or the cash flows of the hedging instrument. Therefore, the staff think IAS 39 should be amended to provide relief from the effects of IBOR reform uncertainties on the prospective assessment. This means that, to demonstrate whether the hedge is expected to be highly effective in achieving offsetting, an entity should consider only the existing contractual terms of the hedging instrument and hedged item. Potential future amendments to underlying contracts due to IBOR reform should not affect the assertion that the hedge is expected to

be highly effective in achieving offsetting. The proposed relief is optional and applies to all types of hedges of interest rate risk noted in paragraph 45 above.

51. With respect to IFRS 9, the prospective assessment requires entities to demonstrate the existence of an economic relationship. While IFRS 9 does not specify a method for assessing whether an economic relationship exists, paragraph B6.4.13 of IFRS 9 states that an entity should use a method that captures the relevant characteristics of the hedging relationship including the sources of hedge ineffectiveness. Also, as IFRS 9 does not require a retrospective test as required by IAS 39, this increases the importance of IFRS 9 prospective assessment as a qualifying criterion. Therefore, the staff think IFRS 9 should be amended to provide relief from the effects of IBOR reform uncertainties on the positive assertion that an economic relationship exists. In particular, similar to the proposed amendments to IAS 39, the staff think IFRS 9 should be amended to clarify that a hedging relationship would not fail the prospective assessment because of uncertainties on whether and how the hedged item or the hedging instrument will be contractually amended as a result of IBOR reform. This means that, to demonstrate whether an economic relationship exists, an entity should consider only the existing contractual terms of the hedging instrument and hedged item. Regarding highly probable forecast transactions, potential future amendments to underlying contracts due to IBOR reform should not affect the assertion that an economic relationship exists. The proposed relief is optional and applies to all types of hedges of interest rate risk noted in paragraph 45 above.
52. As noted in paragraph 7, the proposals in this paper aim to provide relief only from the effects of IBOR reform uncertainties on the prospective assessments required by IFRS 9 and IAS 39. This assertion does not impact nor change the actual results of a hedge and thus does not affect measurement. Consequently, while the proposed solution would provide relief for this specific forward-looking assertion (ie the prospective assessments), entities would still need to measure and recognise ineffectiveness that may arise provided the 'lower of' test does not apply.
53. The staff are not proposing an evaluation of the fundamental concept of economic offset between the hedged item and the hedging instrument which is the pillar

supporting the hedge accounting model in both IFRS 9 and IAS 39.<sup>6</sup> The staff think it is critical to maintain this fundamental concept. This means that entities would still have to evaluate whether or not such an offset exists through the prospective assessments and measurement of hedge ineffectiveness throughout the life of a hedging relationship. In other words, if a hedging relationship fails the prospective assessments due to reasons other than uncertainties from IBOR reform, the proposed relief would not apply and thus that hedging relationship should be discontinued as required by IFRS 9 and IAS 39. In addition, as discussed in paragraph 7, the staff think the economics of hedging instruments and hedged items should be captured in financial reporting and the proposals in this paper are designed to maintain this concept unchanged. In particular, the actual economics of these instruments will be captured through measurement, which is not affected by the proposed relief.

54. In case the Board agrees with the staff recommendation to amend IFRS 9 and IAS 39, we think the proposed amendments should clarify the Board's intention to provide relief from effects arising solely from IBOR reform. In other words, if a hedging relationship fails the prospective assessment due to reasons other than uncertainties on whether and how the hedging instrument or the hedged item will be contractually amended as a result of IBOR reform, that hedging relationship would not qualify for hedge accounting under IFRS 9 and IAS 39. The staff think the proposed amendments should also make it clear that all other hedge accounting requirements must be applied as stipulated by IFRS 9 and IAS 39.<sup>7</sup>

#### *Illustrative example – prospective assessments*

55. To illustrate the application of the proposed relief, assume the same fact pattern in paragraph 30 where an entity issues a 5-year floating-rate debt instrument, which pays interest quarterly at 3-month IBOR. The entity also enters into a 5-year interest rate swap under which it receives 3-month IBOR and pays a fixed rate of

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<sup>6</sup> Refer to paragraph B6.4.7 of IFRS 9.

<sup>7</sup> The staff highlight that, in a similar situation in the past (June 2013), the Board considered the financial reporting effects arising from novations that result from new laws or regulations and decided to amend IAS 39 to provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument met certain criteria.

4.0%. Assuming the relationship meets all the qualifying criteria for cash flow hedge accounting,<sup>8</sup> the entity designates the forecast 3-month IBOR interest payments as the hedged item and the interest rate swap as the hedging instrument. In this scenario, the existing contractual obligation would typically support the assertion that the forecast IBOR interest payments are highly probable at inception of the hedging relationship. As IBOR reform approaches, there would be an increased probability that the debt instrument will be amended to reflect the alternative RFR and thus, at some point, the designated forecast IBOR interest payments would fail the highly probable requirement. In this situation, the entity applies the proposed amendments discussed in paragraph 27 and thus the hedged item does not fail the highly probable requirement.

56. In addition, as part of the set of qualifying criteria an entity must comply with in order to apply hedge accounting, the entity is required to demonstrate the existence of an economic relationship under IFRS 9 (or expectation that the hedge will be highly effective, if hedge accounting is applied under IAS 39). In the illustrated scenario, uncertainties from IBOR reform might affect the entity's expectation regarding the future cash flows arising from both the hedged item (ie forecast IBOR interest payments) and the hedging instrument (ie the interest rate swap), since both instruments might be contractually amended to reflect the alternative RFR. While the general conditions (timing and specifics) for the replacement of IBOR have not been determined yet, applying the proposed relief to the prospective assessments would allow the entity to consider only the existing contractual terms of the hedging instrument and hedged item until they are amended to reflect the alternative RFR.
57. It is important to note the proposed amendments would provide relief from the effects of IBOR reform uncertainties on specific forward-looking assertions an entity needs to make when applying hedge accounting. As noted in paragraph 7, these assertions do not change the actual results of the hedge and thus do not affect measurement of the hedging instrument and hedged item. For example, continuing the above scenario, as conditions of IBOR reform develop and time to

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<sup>8</sup> While this relationship qualifies for cash flow hedge, as noted in paragraph 36 of this paper, the staff highlight that the prospective assessments applies to both fair value and cash flow hedges.

transition approaches, assume liquidity constraints start affecting the fair value of designated hedging instrument (ie the interest rate swap). This would represent the economics of the hedging instrument and therefore would be captured in financial reporting through measurement of the interest rate swap. In other words, the interest rate swap would continue to be measured at fair value on the statement of financial position with the effective portion of changes in fair value recorded in the cash flow hedge reserve and any remaining gain or loss recognised in profit or loss, provided the 'lower of test' does not apply.

58. The staff highlight that, if the hedging relationship failed the highly probable requirement or the prospective assessments due to any reason other than uncertainties on whether and how the hedging instrument or the hedged item will be contractually amended as a result of IBOR reform, that relationship would not qualify for hedge accounting. This is because the proposed amendments provide relief from effects arising solely from IBOR reform uncertainties.
59. The period over which entities could apply such a relief is discussed in paragraphs 95 – 104.

#### *Staff recommendation*

60. For the reasons stated in paragraphs 48 – 59, the staff are of the view that IAS 39 and IFRS 9 should be amended to provide relief from the effects of IBOR reform uncertainties on the prospective assessments. This means that, to demonstrate the existence of an economic relationship in accordance with IFRS 9, or whether the hedge is expected to be highly effective in achieving offsetting as per IAS 39, an entity should consider the existing contractual terms of the hedging instrument and hedged item until they are amended to reflect the alternative RFR. Regarding highly probable forecast transactions, potential future amendments to underlying contracts due to IBOR reform should not affect the assertions that an economic relationship exists in accordance with IFRS 9 or the hedge is expected to be highly effective in achieving offsetting as per IAS 39.
61. Providing such a relief would not impact measurement of the hedged item nor the hedging instrument because the prospective assessments do not change the actual results of a hedge. Entities would still have to perform the prospective assessments and measure hedge ineffectiveness throughout the life of a hedging

relationship. Relief is provided solely from uncertainties arising from IBOR reform.

### Question for the Board

#### Question for the Board

- 1) Does the Board agree with the staff recommendation in paragraphs 33 - 35 and 60 that IFRS 9 and IAS 39 should be amended to provide relief from the effects of IBOR reform uncertainties on the highly probable requirement and prospective assessments required in both standards?

### Risk components

62. Following the December 2018 Board meeting, the staff received additional feedback from constituents and considered whether the requirements for designation of a risk component as the hedged item in a hedging relationship could be impacted by IBOR reform. These issues could affect financial reporting before IBOR reform is enacted, as they could lead to discontinuation of hedge accounting and/or preclude designation of new hedging relationships, and thus are addressed in the first phase of the project.

#### *Background*

63. An entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship. More specifically, paragraph 6.3.7(a) of IFRS 9 and paragraph 81 of IAS 39 allow entities to designate only changes in the cash flows or fair value of an item attributable to a specific risk or risks (risk component). For example, assuming an entity issues a 5-year floating-rate debt instrument that bears interest of 3-month LIBOR + 1%, the entity could designate either the entire debt instrument (ie all of the cash flows) or the 3-month LIBOR risk component of the floating-rate debt instrument.
64. While the words in IFRS 9 and IAS 39 are slightly different, both standards require a risk component to be separately identifiable and reliably measurable (SIRM). In addition, although the permitted risk components of non-financial

assets are different in IFRS 9 and IAS 39, designation of non-financial items is not relevant for this paper. This is because, as noted in paragraph 11, this paper focuses on hedges of interest rate risk only.

65. The SIRM requirement applies to both cash flow and fair value hedges. In particular, paragraph B6.3.8 of IFRS 9 states:

To be eligible for designation as a hedged item, a risk component must be a separately identifiable component of the financial or the non-financial item and the changes in the cash flows or the fair value of the item attributable to changes in that risk component must be reliably measurable.

66. Similarly, paragraph AG99F of IAS 39 states:

To be eligible for hedge accounting, the designated risks and portions must be separately identifiable components of the financial instrument, and changes in the cash flows or fair value of the entire financial instrument arising from changes in the designated risks and portions must be reliably measurable.

67. When designating risk components as hedged items, an entity considers whether the risk component is explicitly specified in a contract (contractually specified risk components) or whether they are implicit in the fair value or the cash flows of an item of which they are a part (non-contractually specified risk components). The assessment of whether a risk component is separately identifiable may be straight forward when the component is explicitly stated in a contract. In the example above, 3-month LIBOR is a separately identifiable risk component because the risk component is explicit in the contract. The staff expect limited impacts of IBOR reform on the assessment of whether contractually specified risk components are separately identifiable for both IFRS 9 and IAS 39 because contractually specified components are a matter of fact and thus would require limited judgement.

68. Identifying a non-contractually specified risk component is more difficult. It requires an assessment of facts and circumstances around the particular market structure to which the risks relate. To determine whether a risk component is

SIRM, an entity assess such risk components within the context of the particular market structure to which the risk relates and in which the hedging activity takes place.<sup>9</sup> In that respect, paragraph B6.3.10(d) of IFRS 9 provides the following example where a benchmark rate such as LIBOR is separately identified as a non-contractually specified risk component of the debt instrument:<sup>10</sup>

Entity D holds a fixed-rate debt instrument. This instrument is issued in an environment with a market in which a large variety of similar debt instruments are compared by their spreads to a benchmark rate (for example, LIBOR) and variable-rate instruments in that environment are typically indexed to that benchmark rate. Interest rate swaps are frequently used to manage interest rate risk on the basis of that benchmark rate, irrespective of the spread of debt instruments to that benchmark rate. The price of fixed-rate debt instruments varies directly in response to changes in the benchmark rate as they happen. Entity D concludes that the benchmark rate is a component that can be separately identified and reliably measured. Consequently, Entity D may designate hedging relationships for the fixed-rate debt instrument on a risk component basis for the benchmark interest rate risk.

69. In this example, LIBOR can be identified as a risk component because variable-rate instruments in that environment are typically indexed to LIBOR and interest rate swaps are frequently used to manage LIBOR risk.
70. The above example illustrates a fact pattern where a non-contractually specified risk component is considered SIRM, however, paragraph B6.3.14 of IFRS 9 discusses an example of market structure in which a non-contractually specified risk component cannot. In particular, paragraph B6.3.14 of IFRS 9 states:

[...] in many cases an inflation risk component is not separately identifiable and reliably measurable. For example, an entity issues only nominal interest rate debt in

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<sup>9</sup> Refer to paragraph B6.3.9 of IFRS 9.

<sup>10</sup> A similar example is provided in paragraph AG99F of IAS 39.

an environment with a market for inflation-linked bonds that is not sufficiently liquid to allow a term structure of zero-coupon real interest rates to be constructed. In this case the analysis of the market structure and of the facts and circumstances does not support the entity concluding that inflation is a relevant factor that is separately considered by the debt markets. Hence, the entity cannot overcome the rebuttable presumption that inflation risk that is not contractually specified is not separately identifiable and reliably measurable [...]. This applies irrespective of any inflation hedging instrument that the entity has actually entered into.

71. The above example illustrates a market structure that is not sufficiently liquid to allow a term structure of zero-coupon real interest rates to be constructed and concludes that hedge accounting is not achieved because the risk component is not separately identifiable.
72. The most specific guidance in IAS 39 is found in its paragraph 81 which states ‘an identifiable and separately measurable portion of the interest rate exposure of an interest-bearing asset or interest-bearing liability may be designated as the hedged risk (such as a risk-free rate or benchmark interest rate component of the total interest rate exposure of a hedged financial instrument)’. While the words in IFRS 9 and IAS 39 are not the same, the staff believe this does not impact the analysis in this paper because the concepts and principles are very similar.

### *Implications*

73. In order to qualify for hedge accounting, the hedged item must be eligible and more specifically, if a risk component is the designated hedged item, it must be separately identifiable. In view of this, assuming a scenario where IBOR reform impacts market liquidity to an extent that there is no available term structure of zero-coupon interest rate for either IBOR or RFR benchmarks, this could affect the assessment of whether non-contractually specified IBOR and RFR components are eligible as a hedged item in a hedging relationship.
74. With respect to new IBOR and new RFR hedges, if the situation described in paragraph 73 occurs, new designations of IBOR and RFR as non-contractually

specified risk components would be prevented because they would not be separately identifiable at initial designation irrespective of any hedging instrument that the entity has actually entered into. Alternatively, entities could designate the entire fair value or all the cash flows of the interest-bearing financial instrument in a hedging relationship. However, the entity would be required to measure the effectiveness of that relationship based on all the cash flows (or fair value), rather than a component. This would most likely increase measured ineffectiveness. This implies, at a minimum, achieving hedge accounting would be more difficult for IBOR-based hedging instruments when a term structure of zero-coupon IBOR interest rates cannot be constructed. These concerns apply equally to RFR based hedging instruments if a term structure of zero-coupon RFR interest rates cannot be constructed.

75. While paragraph 74 discusses the concerns raised on new designations, another question remains regarding the impact, if any, on hedging relationships designated prior to the inability to demonstrate separately identifiability. This is discussed in the following paragraphs.

*Frequency of SIRM assessment and implications for existing IBOR hedges*

76. The discussion about frequency of the SIRM assessment is important because this will define the population of hedging relationships affected by IBOR reform with respect to the separately identifiable requirement.
77. IAS 39 and IFRS 9 provide specific guidance about requirements that must be met only at initial recognition (eg embedded derivatives, SPPI test, etc). Both standards also provide explicit guidance when other assessments need to be performed on a continuous basis (ie prospective assessments, the highly probable requirement, etc). Risk components that are separately identifiable are generally discussed in the context of initial designation, which occurs at inception of the hedging relationship.
78. In particular, while paragraph 81 of IAS 39 states that an identifiable and separately measurable portion of the interest rate exposure is eligible for hedge accounting purposes, there is no explicit requirement for a continuous assessment. The same applies to IFRS 9, since paragraph 6.3.7 states that an entity may designate a risk component provided it is separately identifiable and reliably

measurable. In addition, the SIRM requirement is discussed in section ‘Designation of hedged items’ of IFRS 9 and, because designation of hedge accounting occurs only at inception of a hedging relationship, it can be argued that identification is only required at the time of designation.

79. The staff also note that, once the risk component has been separately identified, this will define the basis for assessing ineffectiveness of that relationship going forward. For example, for cash flow hedges, the designated risk component would define the characteristics of the hypothetical derivative. In case of fair value hedges, the risk component will define the basis for measuring the fair value adjustment on the hedged item. Since neither the hypothetical derivative nor the basis on which the fair value adjustment is measured change over the life of a hedging relationship, there is no need to separately re-identifying a risk component that has already been defined and designated at the inception of hedging relationship.
80. For the reasons discussed in paragraphs 76 - 79, the staff think the assertion of separate identifiability is required only at initial designation of a hedging relationship. Therefore, in the event that entities can no longer assert IBOR is separately identifiable based on market structure, this would not require the discontinuation of relationships already designated.

*New designation: Relevant scenarios*

81. As discussed in paragraph 80, given that the requirement for separate identification applies only at inception of the hedging relationship, non-contractually specified IBOR components designated in existing hedging relationships would not be impacted by IBOR reform nor would new designations as long as IBOR continue to be separately identifiable. This significantly reduces the scope of the potential concerns involving new relationships where the entity wants to designate a non-contractually specified risk component. Realistically, the concerns discussed in this paper will arise in two scenarios:
- (a) When an entity wishes to designate the alternative RFR as a risk component when a term structure of zero rates is available for IBOR but the RFR market has not yet sufficiently developed; or

- (b) When an entity wishes to designate IBOR as a risk component but the market has transitioned away from IBOR to the alternative RFR and a term structure of zero rates is no longer available for IBOR.
82. A scenario where neither IBOR or RFR is separately identifiable was not considered in our analysis because it is unlikely that there would be no available term structure of zero-coupon interest rate for both IBOR and RFR benchmarks in the same period. This would imply a greater impact in interest rate markets which seems unlikely at this stage.
83. In addition, if IBOR is no longer separately identifiable but the RFR is, this would indicate reform has been enacted and thus any issues arising on transition would be addressed in the second phase of the project as more information about IBOR reform becomes available.
84. Therefore, the scope of the concern surrounding designation of new relationships appears limited to RFR based hedging activities when the RFR market has not yet developed to a stage where a term structure of zero-rates can be constructed.

### *Staff analysis*

85. Amending IFRS 9 and IAS 39 to provide relief from this requirement would permit entities to designate IBOR and RFR as non-contractually specified risk components even though the component may not be separately identifiable at the time of designation. In other words, IBOR and RFR would be considered separately identifiable regardless of the market structure for a period of time. In the following paragraphs, the staff discuss two possible views:
- (a) View A: not to amend IFRS 9 and IAS 39
- (b) View B: amend IFRS 9 and IAS 39

### *View A: not to amend IFRS 9 and IAS 39*

86. The staff is concerned that any proposed solution for risk components would impact the definition of the hedged item. Without a term structure of zero-coupon interest rates, the entities' ability to independently define the hedged item would be reduced. For example, due to the lack of observable data, entities would likely estimate changes in fair value of the hedged item based on the same valuation inputs used to estimate changes in fair value of the hedging instrument. The staff

is concerned that this would violate the view that the ‘hedge accounting model requires that the value of the hedged item is measured independently of that value of the hedging instrument’ and, consequently, the general notion of offset between gains and losses on the hedging instrument and the hedged item on which the hedge accounting model in IFRS 9 and IAS 39 is based.<sup>11</sup> Additionally, this would contradict the statement that “the entity cannot simply impute the terms and conditions of the actual inflation hedging instrument by projecting its terms and conditions onto the nominal interest rate debt” made in paragraph B6.3.14 of IFRS 9.

87. The staff also think that allowing designation of non-contractually specified RFR components when such components are not separately identifiable could be challenging. This is because the future of these RFR benchmarks is unknown and thus unintended consequences could arise as a result of such relief. For example, according to paragraph 6.5.8(b) of IFRS 9 and paragraph 89(b) of IAS 39, in a fair value hedge, the gain or loss on the hedged item should adjust the carrying amount of the hedged item and be recognised in profit or loss. Therefore, if a risk component that is not separately identifiable is designated in a fair value hedge, this would result in recognition of gains or losses in the statement of profit or loss for a component that is not separately identifiable.
88. Furthermore, if designation of risk components that are not separately identifiable was permitted, this would indicate that the designated component is separately considered by the market when determining the fair value of the hedged item. This may distort the underlying economics of the hedge relationship because it implies measurement of effectiveness is based on the structure of the relevant market, even though that may not be the case. One could argue the resulting information may not be useful for users of financial reporting.
89. It is important to note that if relief is provided for non-contractually specified RFR components, the staff anticipate that it could be challenging to identify and define each RFR for which relief would be provided. This is because, although there is some detail on what the new RFR can be in certain jurisdictions, the replacement will occur in several jurisdictions, and IFRS Standards do not provide

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<sup>11</sup> Refer to paragraph B6.4.7 of IFRS 9 and paragraph BC6.290 of the Basis for Conclusions of IFRS 9.

a prescriptive list of rates eligible as risk components. In addition, even if more information becomes available and it is possible to identify and define a comprehensive list of RFR benchmarks eligible as risk components, it might not be possible for the staff to predict whether all RFR will become separately identifiable in the future. Said differently, the staff cannot guarantee that all alternative RFRs will eventually meet the separately identifiable requirement and therefore, a relief that was once expected to be provisional, could become indeterminately applicable.

90. Finally, the staff highlight that entities would be able to designate a financial instrument in its entirety (ie all cash flows or full fair value) as an alternative to component hedging. While this would result in more ineffectiveness, all other things being equal, hedge accounting would still be permitted.

*View B: amend IFRS 9 and IAS 39*

91. Amending IFRS 9 and IAS 39 to provide relief from this requirement would permit entities to designate IBOR and RFR as non-contractually specified risk components when that component is not separately identifiable. In other words, IBOR and RFR would be considered separately identifiable regardless of the market structure for a period of time. The period over which entities could apply such a relief is discussed in paragraphs 95 – 104.
92. The staff think this would provide a clear direction to constituents regarding the eligibility of these benchmarks as a risk component and thus would reduce uncertainties regarding future designations due to the effects of IBOR reform. As noted in paragraph 25, the inability to qualify for hedge accounting could have an impact on financial reporting and key accounting ratios (including regulatory ratios such as CET 1) for a number of IFRS preparers globally. Given the unique nature of IBOR reform and the expectation of a smooth transition from IBOR to the alternative RFR, one could argue that requiring fair value through profit or loss for certain hedging instruments would not provide useful information to users of financial reporting.
93. Specifically, regarding new RFR hedges, given the market expectation is that the alternative RFR will replace IBOR, one could argue that this relief is temporary in nature and therefore, the concerns raised in paragraph 86 – 90 are lessened.

*Staff recommendation*

94. On balance, considering the arguments stated in paragraphs 86 – 93, the staff are of the view that the Board should not amend the hedge accounting model in IFRS 9 and IAS 39 to provide relief for designation of risk components that are not separately identifiable. The staff do not think the impacts on definition of the hedged item and consequential impacts on ineffectiveness are warranted given the affected population of hedging relationships, especially considering the clarification already provided in paragraph 80 regarding frequency of assessment.

**Question for the Board****Question for the Board**

- 2) Does the Board agree with the staff recommendation in paragraph 94?

**End of the proposed relief**

95. We use the term ‘IBOR reform’ to refer to a market wide reform of benchmark interest rates. The staff note that IBOR reform will likely follow different timelines in different jurisdictions. In this context, the staff highlight that it is difficult to define a period of applicability for the proposed amendments because, thus far, there are no dates specifying when IBOR reform will start and when it will end.
96. While, at this stage, it is not possible to determine the end of IBOR reform, the staff think it is important to define when the relief proposed in this paper will no longer be available. This is because the transitional period from IBOR to new RFR will be temporary and, without defining the end of the proposed relief, the Board will need to amend IFRS 9 and IAS 39 again when uncertainties arising from IBOR reform are no longer present and thus there would be no need for such relief. However, given that markets may develop at different speeds, proposing an approach whereby the proposed relief is deleted at some point in the future is difficult because it would preclude certain jurisdictions from using the relief when it may be required whilst allowing it for others where it is not. Therefore, the staff

think the end of the proposed relief needs to be linked to the structure of the market.

97. In view of this, if the Board agrees with the recommendations in this paper, the following paragraphs discuss the period over which an entity could apply the proposed relief.

*Highly probable requirement and prospective assessments*

98. The proposed amendments provide relief from uncertainties arising from IBOR reform that would otherwise impact the highly probable requirement and prospective assessments in IFRS 9 and IAS 39. As a result, when these uncertainties are no longer present, entities would not require relief from the requirements of IFRS Standards as originally issued. In this context, the staff have identified two questions regarding hedge relationships:

- (a) When should hedging relationships that have used the proposed relief stop using the said relief; and
- (b) When should designation of new relationships revert to the hedge accounting requirements as originally written (ie they need to be designated without using the proposed relief).

99. For the first group of transactions (ie hedging relationships using the proposed relief), when an IBOR financial instrument is contractually amended to reflect the alternative RFR, the uncertainties arising from IBOR reform would no longer affect both the highly probable requirement and the prospective assessments. Therefore, the staff think an entity should stop applying the proposed relief when the earlier of the following occurs:

- (a) the designated IBOR financial instrument is contractually amended to replace IBOR for the alternative RFR; or
- (b) the hedging relationship terminates.

100. In addition, as noted in paragraph 19, IBOR reform might also impact reclassification of the amount accumulated in the cash flow hedge reserve related to hedging relationships that have been previously discontinued for reasons other than IBOR reform. For the same reasons stated in paragraph 99 above, an entity should apply the proposed relief for this specific scenario until the earlier of

contractual amendment or the cash flow hedge reserve has been fully reclassified to the statement of profit or loss. This would allow these relationships to “run-off” until they are contractual amended. The impact of contractual amendments on existing hedge relationships will be discussed in Phase II of the project.

101. The staff think that when the alternative RFR becomes separately identifiable, this implies the market has developed and entities should have clarity regarding the transition from IBOR to the alternative RFR and the impact on their contracts and operations. Consequently, with respect to the second group of hedging relationships noted in paragraph 99(b) above, the staff propose that entities be not permitted to apply the proposed relief for all hedging relationships designated after the RFR is separately identifiable. This is because, when the RFR is separately identifiable, there would be no uncertainty arising from IBOR reform and thus no need for such relief. At this point, entities must use the requirements of IFRS Standards as originally issued.

### *Risk components*

102. As noted in paragraph 94, the staff is not recommending relief for designation of risk components that are not separately identifiable. However, in case the Board decides to provide relief for such risk components, the staff have considered the period over which an entity should apply such relief.
103. For those relationships that have applied relief, given that separate identification is required at initial designation only, the staff think entities should stop applying the proposed relief when the earlier of the following occurs:
- (a) the designated IBOR financial instrument is contractually amended to replace IBOR for the alternative RFR; or
  - (b) the hedging relationship terminates.
104. Similarly, with respect to the second group of hedging relationships noted in paragraph 98(b) above, the staff propose that entities be prohibited from applying the proposed relief for all hedging relationships designated after the RFR is separately identifiable. This is because, when the RFR is separately identifiable, the relief becomes redundant as entities would be able to meet the separately identifiable requirement when designating the RFR as a risk component.

## Question for the Board

### Question for the Board

3) Does the Board agree with the staff recommendation regarding end of relief?

## Disclosures

105. As noted in paragraph 7, the proposals discussed in this paper aim to provide relief from the effects of IBOR reform uncertainties on the highly probable requirement and prospective assessments required by IFRS 9 and IAS 39. Therefore, the objective of the disclosures discussed in the proceeding paragraphs is to provide users with information about the extent to which entities are applying the proposed relief.
106. The staff note that *IFRS 7 – Financial Instruments: Disclosures* (IFRS 7) already requires specific disclosures about hedge accounting. The staff think that some of these IFRS 7 disclosures, if provided in the context of entities applying the proposed relief, would achieve the objective noted in paragraph 105 above. The staff think the proposed disclosures will not be onerous to preparers because these disclosures are already required by IFRS 7 for existing hedges.
107. The staff propose that an entity applying the proposed relief should disclose the following information in the notes of the financial statements:
- (a) For hedging instruments in either fair value or cash flow hedges:<sup>12</sup>
    - (i) the carrying amount;
    - (ii) the nominal amount; and
    - (iii) the change in fair value used as the basis for recognising ineffectiveness for the period.
  - (b) For hedged items in fair value hedges:<sup>13</sup>
    - (i) the carrying amount;

<sup>12</sup> Consistent with paragraph 24A of IFRS 7.

<sup>13</sup> Consistent with paragraph 24B(a) of IFRS 7.

- (ii) the accumulated amount of fair value hedge adjustments;
  - (iii) the line item in the statement of financial position that includes the hedged item; and
  - (iv) the change in fair value used as the basis for recognising ineffectiveness for the period.
- (c) For cash flow hedges:<sup>14</sup>
- (i) the balance in the cash flow hedge reserve and the amount transferred to profit or loss; and
  - (ii) the change in fair value used as the basis for recognising ineffectiveness for the period.

108. In practice, the staff expect that entities applying the proposed relief will provide these disclosures as a subset of the information already required by IFRS 7 in the context of hedge accounting.

### Questions for the Board

**Questions for the Board**

4) Does the Board agree with the staff recommendation regarding disclosures?

### Effective date

109. If the Board agrees with the recommendations in this paper, the staff think the relief should be made available as soon as possible to allow entities to apply the relief before it is required to discontinue hedge accounting due to the uncertainties arising from the IBOR reform. The staff therefore recommend the proposed effective date of annual periods beginning on or after 1 January 2020. In addition, the staff think that earlier application should be permitted for the same reason.
110. With respect to the application, the staff think the relief should be applied retrospectively. The staff highlight that retrospective application is limited to the application of the specific relief proposed in the amendments. This means that it

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<sup>14</sup> Consistent with paragraph 24B(b) of IFRS 7.

would not allow reinstating hedge accounting that has already been discontinued in previous financial statements. Nor would it allow designation in hindsight. If an entity had not designated an item as a hedging instrument or a hedged item in a qualifying hedging relationship, this relief, even if applied retrospectively, would not allow the entity to go back in time to designate such an item as a hedge that qualifies for hedge accounting. Doing so would be against the requirement that hedge accounting applies prospectively. Retrospective application of the relief would enable entities to continue hedge accounting for a hedging relationship that the entity has already designated and that qualifies for hedge accounting applying IAS 39 or IFRS 9.

111. The staff note that this approach is consistent with the approach taken for the *Novation of Derivatives and Continuation of Hedge Accounting* (Amendments to IAS 39 and IFRS 9).
112. With respect to transition provision, the staff do not think any specific transition provisions are necessary given the proposed relief is intended to help entities continue applying the same accounting as the entity is already applying as opposed to transiting to new requirements. The staff therefore do not propose any specific transition provisions.

### Question for the Board

#### Question for the Board

- 5) Does the Board agree with the staff recommendation regarding the effective date?

### High-level project timeline

113. If the Board decides to proceed with the proposed amendment described in this paper, we think that proposal should be published as quickly as possible.

114. We have prepared a high-level project timeline assuming a short comment period. We have prepared an agenda paper to inform the Due Process Oversight Committee (DPOC) about the urgency of the project. Subsequent to the discussions with the Board, the staff plan to request the DPOC for approval of a short comment period.

<b>Timeline</b>	<b>Project plan</b>
March 2019	Board finishes deliberations, including the comment period, due process steps and permission to ballot.  Proceed with drafting those amendments.
April / May 2019	Publish an Exposure Draft
June / July 2019	Comment period ends
September / October 2019	Board re-deliberations
November / December 2019	Issue final amendment

## STAFF PAPER

February 2019

## IASB® meeting

Project	Primary Financial Statements		
Paper topic	Classification of income and expenses by financial entities		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

**Purpose of this paper**

1. At its September 2018 meeting, the Board discussed the scope of the proposals for required subtotals in the statement(s) of financial performance. At that meeting, Board members agreed with the general direction of the staff proposals but made a number of suggestions. This paper analyses most of those suggestions and further refines the proposals.
2. The staff will bring another paper to a future meeting to analyse the remaining suggestions.
3. By financial entities, we mean entities that provide financing to customers as a main business activity and/or invest in the course of their main business activities in assets that generate a return individually and largely independently of other resources held by the entity.

**Summary of staff recommendations**

4. The staff recommend that the Board reformulates its September 2018 tentative decisions as follows:
  - (a) an entity that provides financing to customers as a main business activity is required to include in operating profit either:

- (i) expenses from financing activities and income from cash and cash equivalents relating to its financing business activity; or
  - (ii) all expenses from financing activities and income from cash and cash equivalents.
- (b) an entity that, in the course of its main business activities, invests in assets that generate a return individually and largely independently of other resources held by the entity is required to include in operating profit, income (expenses) from investments made in the course of its main business activities.
- (c) an entity that provides financing to customers as a main business activity shall not present the ‘profit before financing and income tax’ subtotal if the entity does not present expenses from financing activities or income from cash and cash equivalents below operating profit. This exception applies even when such an entity presents in the statement(s) of financial performance the unwinding of a discount on liabilities that do not arise from financing activities.

## Structure of paper

5. This paper is structured as follows:
- (a) Background—Board members’ suggestions related to the approach proposed in September 2018 (paragraphs 6–13);
  - (b) Staff analysis (paragraphs 14–62)
    - (i) Which income and expenses should be classified in operating profit? (paragraphs 19–23)
    - (ii) Should there be further exceptions or exemptions? (paragraphs 24–44)
    - (iii) What does the new classification model for financial entities mean for presentation of subtotals? (paragraphs 45–52)
    - (iv) How do the proposals in this paper compare with the September 2018 staff proposals? (paragraphs 53–54)

- (v) Classification of expenses from financing activities for insurers (paragraphs 55–62)
- (c) Appendix A— Tentative Board decisions on subtotals for non-financial entities
- (d) Appendix B— Extract from September 2018 IASB *Update*
- (e) Appendix C—Comparison of staff proposals in this paper with September 2018 staff proposals

### **Background—Board members’ suggestions related to the approach proposed in September 2018**

6. At its September 2018 meeting, the Board discussed how to define the scope of the three subtotals it has tentatively decided to require in the statement(s) of financial performance.<sup>1</sup> The aim was to define the scope in a way that ensures the subtotals are only required when they result in useful information.
7. Table 1 summarises the staff’s proposed approach at the September 2018 Board meeting.<sup>2</sup> Board members agreed with the general direction of the staff proposals and with the outcomes illustrated in [Agenda Paper 21B](#) for that meeting. However, Board members made several suggestions which are described in paragraphs 8–13.

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<sup>1</sup> Appendix A describes the Board’s tentative definitions of these subtotals in more detail.

<sup>2</sup> Appendix B includes the September 2018 IASB *Update*.

Table 1—expected effect of the staff proposals discussed at the September 2018 Board meeting<sup>3</sup>

		Classification		Subtotals			
		Income from financing activities & expenses from cash & cash equivalents	Income/ expenses from investments	Operating profit	Operating profit & share of int. ass./JVs	Profit before financing & income tax	
One main activity	1	General corporates	All below operating profit	All below operating profit	✓	✓	✓
	2	Entities whose only main business activity is providing financing to customers (eg traditional banks)	All above operating profit <b>OR</b> all below operating profit	All below operating profit	✓	✓	✗
	3	Entities who invest <sup>4</sup> in the course of their only main business activity (eg investment property companies & insurers)	All below operating profit (except insurance finance expense/ income above operating profit)	Split: In course of main business activity above operating profit; rest below <b>OR</b> all below operating profit	✓	✗	✓
Multiple main activities	4	Entities whose main business activities only comprise investing <sup>4</sup> and provision of financing to customers (eg universal banks <sup>5</sup> )	All above operating profit <b>OR</b> all below operating profit	Split: In course of main business activity above operating profit; rest below <b>OR</b> all below operating profit	✓	✗	✗
	5	Entities whose main business activities comprise both a non-financial main business activity and provision of financing to customers	Split: Related to provision of financing to customers above operating profit; rest below <b>OR</b> all below operating profit	All below operating profit	✓	✓	✓
	6	Entities whose main business activities comprise both a non-financial main business activity and investing <sup>4</sup>	All below operating profit	Split: In course of main business activity above operating profit; rest below <b>OR</b> all below operating profit	✓	✓	✓
	7	Entities whose main business activities comprise a non-financial main business activity, provision of financing to customers and investing <sup>4</sup>	Split: Related to provision of financing to customers and investing above operating profit; rest below <b>OR</b> all below operating profit	Split: In course of main business activity above operating profit; rest below <b>OR</b> all below operating profit	✓	✓	✓

<sup>3</sup> We have updated the labels of the subtotals in this table applying the October 2018 tentative Board decisions (see [October 2018 IASB Update](#)).

<sup>4</sup> By ‘investing’ we mean ‘investing in assets that generate a return individually and largely independently of other resources held by the entity’.

<sup>5</sup> By a ‘universal bank’ we mean an entity that provides a wide variety of financial services, including retail and investment banking services.

*Suggestion 1—Simplifying and reordering the model*

8. Some Board members suggested the proposed model could be simplified if the principles for classification of income and expenses that were proposed for ‘conglomerate’ entities (see rows 5–7 in Table 1) formed the starting point of the model for all entities. Exemptions or exceptions from this general classification model could then be provided for some entities.<sup>6</sup>
9. One Board member suggested there is no need for specific exemptions from the requirement to present subtotals. Instead, the Board could rely on the application of materiality to explain when subtotals may be omitted.

*Suggestion 2—Require vs allow*

10. The September 2018 staff proposals were formulated in a way that *allowed* some financial entities to use a different approach to presentation and classification than non-financial entities. However, some Board members suggested instead financial entities should be *required* to use different classification requirements. This is because Board members thought those classification requirements should not be seen as optional as they resulted in useful information—ie income and expenses related to an entity’s main business activities should be classified in operating profit.

*Suggestion 3—Only main business activity*

11. Many Board members did not support using the wording ‘*only* main business activity’ to describe entities in rows 2, 3 and 4 in Table 1. Board members said this wording was too restrictive and would lead to unintended outcomes in some cases. For example, the exemptions in rows 3 and 4 of Table 1<sup>7</sup> are designed to capture banks. However, many banks’ main business activities do not *only* consist of providing financing to customers and investing. Many banks have additional main business activities such as transaction advisory services.

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<sup>6</sup> Also see paragraphs B2 and B6 of the September 2018 IASB *Update* in Appendix B.

<sup>7</sup> Also see paragraphs B3 and B5 of the September 2018 IASB *Update* in Appendix B.

*Suggestion 4—Expenses from financing activities for insurers*

12. Applying the staff’s September 2018 proposals, we expect most insurers would fall into the category of ‘entities who invest in the course of their main business activity’ in row 3 in Table 1. Therefore, insurers would be required to present a ‘profit before financing and income tax’ subtotal, with expenses from financing activities presented below that subtotal. A few Board members questioned whether the presentation of interest expenses on financial debt below the ‘profit before financing and income tax’ subtotal would result in useful information about insurers. Board members asked the staff to perform further research and outreach on this issue.

*Other suggestions*

13. The staff plan to address the following suggestions at a future meeting:
- (a) a few Board members said that for insurers, management of cash and cash equivalents is likely to be closely linked to the entity’s main investing activity. Therefore, they argued it may be more appropriate to present income from cash and cash equivalents within, rather than below, operating profit.
  - (b) a few Board members suggested replacing the exception for insurance finance expenses (income) (see paragraph B3(c) of Appendix B) with a principle—expenses related to financing *from* customers should be included in operating profit. In other words, the classification of expenses from financing activities should not only depend on what business activity the financing is used for, but should also depend on who the entity receives financing *from*.

**Staff analysis**

14. We propose to redraft the model to address suggestions 1–3 (paragraphs 8–11), while largely retaining the outcomes discussed at the September 2018 Board meeting, with which the Board agreed. In coming up with the proposed approach, our key considerations were:

- (a) classification requirements resulting in useful information should not be optional but rather required. For example, banks should not have a classification option that could result in no interest expenses being included in operating profit.
  - (b) entities should not be required to allocate income and expenses when doing so would be arbitrary or the costs of allocation would outweigh the benefits.
15. Our proposed approach is:
- (a) as a starting point, require all entities to apply the model for general corporates (general model); then
  - (b) consider exceptions or exemptions from the model for financial entities. IFRS 1 *First-time Adoption of International Financial Reporting Standards* uses the term ‘exemption’ for a voluntary approach and the term ‘exception’ for a required approach. We use these terms with the same meaning in this paper.
16. We have considered providing exceptions or exemptions in the following steps:
- (a) provide exceptions from the general model requiring financial entities to classify income and expenses that would be considered a part of a measure of operating performance (but which are not included in operating profit in accordance with the model for general corporates) in operating profit (paragraphs 19–23);
  - (b) specify further exceptions or exemptions from the classification in the general model to provide relief from costly or arbitrary allocation of income and expenses between different sections in the statement(s) of financial performance (paragraphs 24–44); and
  - (c) consider the effects of these classification exceptions or exemptions on the presentation of subtotals, and whether specific exceptions or exemptions from the requirements to present those subtotals are needed (paragraphs 45–52).
17. We compare the proposals in this paper with the September 2018 proposals in paragraphs 53–54. The following tentative Board decisions made in September 2018 are not reconsidered in this paper and remain applicable:

- (a) all entities are required to separately present the share of profit or loss from integral and non-integral associates and joint ventures below operating profit;
  - (b) entities with insurance finance expenses (income) are required to include those expenses (income) in operating profit; and
  - (c) all entities are required to present the unwinding of a discount on liabilities that do not arise from financing activities below operating profit.
18. In addition, we provide feedback from research undertaken in response to suggestion 4 in paragraphs 55–62. That research indicates there is no need to consider changing the model for insurers’ expenses from financing activities.

***Which income and expenses should be classified in operating profit?***

19. When entities provide financing to customers, the margin between the interest income from that activity and the related interest expense (the net interest income) is an important indicator of operating performance. Interest income from the provision of financing to customers is included in operating profit applying the general model<sup>8</sup>. However, the related expenses from financing activities and income from cash and cash equivalents are not. Consequently, to enable entities to present net interest income, we think that entities that provide financing to customers as one of their main business activities, should classify expenses from financing activities and income from cash and cash equivalents relating to the provision of financing to customers in operating profit.<sup>9</sup>
20. Similarly, when an entity, in the course of its main business activities, invests in assets that generate a return individually and largely independently of other resources held by the entity, the investment returns are an important indicator of operating performance. Consequently, we think that such entities should classify income

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<sup>8</sup> This is because interest income from the provision of financing to customers does not meet the definition of income from investments or financing activities (Appendix A includes these definitions).

<sup>9</sup> We think this principle only applies to entities that present income from the provision of financing to customers separately—for example it would apply to finance lessors but not to operating lessors.

(expenses) from investments made in the course of their main business activities in operating profit.

21. In summary, we recommend the following exceptions to the general model:
  - (a) an entity that provides financing to customers as a main business activity is required to include, in operating profit, expenses from financing activities and income from cash and cash equivalents relating to its financing business activity.
  - (b) an entity that, in the course of its main business activities, invests in assets that generate a return individually and largely independently of other resources held by the entity is required to include in operating profit, income (expenses) from investments made in the course of its main business activities.
22. We propose to use ‘in the course of its main business activities’ rather than ‘as a main business activity’ in (b) above. This is because we want to capture cases such as insurers, where investing may not be the main revenue-generating activity but arises in the course of the entity’s main business activities.
23. We consider further exceptions or exemptions in the next subsection.

***Should there be further exceptions or exemptions?***

24. Some Board members and stakeholders have said it will be difficult for some entities to determine which of their liabilities fund the provision of financing to customers and which liabilities fund their other activities. Hence, the approach proposed in paragraph 21(a) would be difficult to apply.
25. On the one hand, we have heard that attributing liabilities to activities is feasible in some cases:
  - (a) some entities are organised in such a way that the provision of financing to customers is isolated in a separate legal entity, which raises its own funding. In these cases, the entity’s liabilities and related expenses can be directly attributed.

- (b) expenses from financing activities are often allocated to different business units or segments within a group for management reporting purposes.
26. However, even when expenses from financing activities are internally allocated such allocation may be based on intercompany pricing and may not involve specific allocation of external financial liabilities. Allocating liabilities and the related expenses could be particularly challenging for entities that have a central treasury department that raises funding for all the entity's activities.
27. We understand that entities who provide both financing to customers and invest<sup>10</sup> in the course of their main business activities (see rows 4 and 7 in Table 1) would also find it difficult to allocate expenses from financing activities to these two activities. For example:
- (a) a bank which grants loans, but also invests in equity instruments may not be able to allocate to these two activities the interest expenses on their deposits and other debt; or
- (b) a bank-insurer may not be able to allocate the interest expenses on their liabilities to their banking and insurance activities.
28. It is therefore questionable whether all entities would be able to allocate expenses from financing activities and income from cash and cash equivalents on a reasonable basis, and without undue costs.
29. We have not found evidence of entities of the types described in paragraph 27 making such an allocation in their financial statements today. We have also not heard any demand from users for such an allocation of expenses from financing activities and income from cash and cash equivalents for such entities.
30. We have therefore considered further exemptions or exceptions that would enable some entities to include *all* expenses from financing and income from cash and cash equivalents in operating profit, including those that are not related to the provision of financing to customers. In our analysis, we considered the following disadvantages of such exceptions or exemptions:

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<sup>10</sup> ie invest in assets that generate a return individually and largely independently of other resources held by the entity.

- (a) exemptions and exceptions reduce comparability between entities that are eligible for an exception or exemption and those that are not.
- (b) exemptions reduce comparability within the set of entities that are eligible for an exemption. In other words, one entity could choose to use an exemption whereas a similar entity from the same industry could choose not to use the exemption.

*Rejected approach—specific exception or exemption*

- 31. We first considered, but rejected, providing a specific exception or exemption for the entities of the type described in paragraph 27, which provide both financing to customers and invest in the course of their main business activities. The Board could require (in the case of exception) or allow (in the case of exemption) such entities to include expenses from financing activities and income from cash and cash equivalents related to investing and providing financing to customers in operating profit.
- 32. The main advantages of such an approach are that:
  - (a) we provide relief for some entities for which the benefits of applying the principle in paragraph 21(a) are unlikely to exceed the costs; and
  - (b) by making the exception or exemption available to a relatively narrow set of entities, we manage any potential loss of comparability.
- 33. However, such an approach would not provide an exception or exemption for the example described in paragraph 11 of banks that provide financing to customers but also have other (non-investing) main business activities such as transaction advisory services. Such banks would be required to apply paragraph 21(a) and split their expenses from financing activities and income from cash and cash equivalents between the provision of financing to customers and those other activities. Entities are likely to incur costs to make such a split, though benefits for users are likely to be limited, because we have not heard any demand from users for such a split for banks. For this reason, we have rejected this approach.

*Proposed approach—general exemption*

- 34. We propose another approach—*allowing* entities that provide financing to customers as a main business activity to include *all* expenses from financing activities and

income from cash and cash equivalents in operating profit. We propose this approach because it would address the case of banks that provide financing to customers but also have other main business activities such as transaction advisory services.

35. Such an ‘allowed’ approach may result in some loss of comparability between similar entities (see paragraph 30(b)). However, entities that have main business activities other than providing financing to customers are likely to choose to split their expenses from financing activities and income from cash and cash equivalents rather than include them all in operating profit. This is because the sum of income and expenses from financing activities and cash and cash equivalents is likely to be a net expense. Therefore, entities will have an incentive to maximise operating profit by making the split. This incentive may help to limit the loss of comparability between similar entities.
36. An entity’s choice as to which approach it uses to classify expenses from financing activities and income from cash and cash equivalents would be treated as an accounting policy as defined by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and disclosed in accordance with paragraph 117 of IAS 1 *Presentation of Financial Statements*.
37. The disadvantage of this approach is that it does not allow entities to ‘mix and match’, for example entities could not move up expenses from financing activities relating to provision of financing to customers and relating to another activity (for example investing) and leave expenses from financing activities relating to a third activity (for example manufacturing) below operating profit. We considered building this option in to the approach but rejected it due to its complexity.
38. We also considered, but rejected, the following variant on the proposed approach: *allowing* entities whose *largest activity* (eg in terms of assets or revenue) is to provide financing to customers to include *all* expenses from financing activities and income from cash and cash equivalents in operating profit. We considered this approach to limit the population of entities that could apply the exemption. However, we rejected this approach because we are unsure whether all the banks we want to capture would meet this ‘largest activity’ criterion and might therefore be required to make allocations which are costly and/or arbitrary (for example a bank that provides both

financing to customers and conducts investing activities may conclude that its investing activities are the largest).

*Should we provide a similar exception or exemption for income (expenses) from investments?*

39. We have heard no feedback from our outreach suggesting that similar problems arise with the allocation of income (expenses) from investments between the investing and operating categories. Given our recommendation to provide an exemption from allocation of expenses from financing activities and income from cash and cash equivalents, we thought it would nevertheless be useful to analyse whether a similar exemption should be provided for income (expenses) from investments.
40. As discussed in paragraph 21(b), an entity would need to make an assessment of whether an investment in a particular asset is made in the course of its main business activities and allocate related income and expenses accordingly. This assessment is likely to involve the exercise of judgement.
41. We think that entities are likely to make a similar assessment when making an investment decision—in other words is the entity investing as part of a main business activity or not (for example in cases when entities invest excess funds whilst awaiting business expansion opportunities). We therefore think that entities could develop a reasonable basis for this assessment and the allocation of investment income between the operating and investing sections of the statement(s) of financial performance would not be arbitrary. However, there may be costs associated with making such an allocation of investment income.
42. Providing an exemption would have the following disadvantages:
  - (a) information about investments not made in the course of an entity's main business activities is likely to be useful to users, regardless of the type of entity. This information would not be provided by entities choosing to apply the exemption.
  - (b) the exemption might create an incentive for entities to include all income from investments in operating profit, as including income from investments in operating profit would be likely to increase that measure.

43. Considering the disadvantages of an exemption and the risk of arbitrary allocation being low, the staff think there should be no exemption from the requirement to allocate income (expenses) from investments between the operating and investing sections in the statement(s) of financial performance.

*Staff recommendation*

44. The staff recommendation in Question 1 below combines the proposals in paragraphs 21 and 34.

**Question 1**

Does the Board agree with the staff recommendation that:

- (a) an entity that provides financing to customers as a main business activity is required to include in operating profit either:
  - (i) expenses from financing activities and income from cash and cash equivalents *relating to its financing business activity; or*
  - (ii) *all* expenses from financing activities and income from cash and cash equivalents.
- (b) an entity that, in the course of its main business activities, invests in assets that generate a return individually and largely independently of other resources held by the entity is required to include in operating profit, income (expenses) from investments made in the course of its main business activities?

***What does the new classification model for financial entities mean for presentation of subtotals?***

45. The staff proposals in September 2018 provided some financial entities with specific exemptions from the requirement to present:

- (a) the ‘profit before investing, financing and income tax’ subtotal; and
  - (b) the ‘profit before financing and income tax’ subtotal.
46. There were no exemptions provided for presentation of the operating profit subtotal— all entities would be required to present operating profit.
47. The staff proposed an exemption from the requirement to present a ‘profit before investing, financing and income tax’ subtotal because such a subtotal would be misleading for entities that include income from investments in operating profit. However, the Board has now tentatively decided to relabel ‘profit before investing, financing and income tax’ as ‘operating profit and share of profit or loss of integral associates and joint ventures’. We think that presentation of an ‘operating profit and share of profit or loss of integral associates and joint ventures’ subtotal would not provide misleading information about entities that include investment income in operating profit. The staff therefore think that the exemption (or exception) from this subtotal is no longer required.<sup>11</sup>
48. However, we think that an exemption or exception from the requirement to present profit before financing and income tax is still required.
49. In some cases, entities that provide financing to customers would:
- (a) include all expenses from financing activities and income from cash and cash equivalents in operating profit; and
  - (b) have no other income or expenses required to be presented in the financing section below the ‘profit before financing and tax’ subtotal (eg the unwinding of a discount on a defined benefit liability).
- Applying materiality, such entities would not be required to present the ‘profit before financing and income tax’ subtotal.
50. In other cases, an entity that provides financing to customers may include all expenses from financing activities and income from cash and cash equivalents in operating profit. However, such an entity may have other income or expenses required to be presented in the financing section below the ‘profit before financing and tax’ subtotal

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<sup>11</sup> Applying the concept of materiality, entities that do not have material income (expenses) from integral associates and joint ventures would not be required to present this subtotal.

(eg the unwinding of a discount on a defined benefit liability). We think that in such cases the label ‘profit before financing and income tax’ would be misleading, because the entity’s expenses from financing activities would be included in the subtotal.

51. We think that, in the circumstances described in paragraph 50, entities should not present a ‘profit before financing and income tax’ subtotal. We think this should be an exception (ie shall not) rather than exemption (ie are not required to) because we do not think that entities should have an option to present a misleading subtotal.
52. Entities that do not provide financing to customers as a main business activity may also have no expenses from financing activities and income from cash and cash equivalents that are presented below operating profit—for example because they are fully equity-financed. However, we think in such cases the presentation of a ‘profit before financing and income tax’ subtotal is not misleading and it can be meaningfully compared with the ‘profit before financing and income tax’ subtotal of other entities that are debt-financed.

### Question 2

Does the Board agree with the staff recommendation that an entity that provides financing to customers as a main business activity shall not present the ‘profit before financing and income tax’ subtotal if the entity does not present expenses from financing activities or income from cash and cash equivalents below operating profit?

### ***How do the proposals in this paper compare with the September 2018 staff proposals?***

53. We think the proposals in this paper would lead to similar outcomes to the September 2018 proposals. Appendix C provides a comparison of expected outcomes of the September 2018 proposals and the proposals in this paper.
54. However, there are differences in the approach between the two sets of proposals in that:

- (a) the September 2018 proposals gave entities an *option* to either include income and expenses which are a part of their key performance metric in operating profit or present them below operating profit.
- (b) the proposals in this paper:
  - (i) *require* entities to include income and expenses which are a part of their key performance metric in operating profit; and
  - (ii) *permit* entities that provide financing to customers to include all their expenses from financing activities and income from cash and cash equivalents into the operating section, avoiding the need to allocate these expenses (income).

### ***Classification of expenses from financing activities for insurers***

#### *Board members' comments*

- 55. Applying the staff's September 2018 proposals, we expect most insurers would fall into the category of 'entities who invest in the course of their main business activity' in row 3 in Table 1. Therefore, insurers would be required to present a 'profit before financing and income tax' subtotal, with expenses from financing activities presented below that subtotal. Expenses from financing activities would include interest expenses on long-term liabilities other than insurance contract liabilities ('financial debt') such as subordinated debt. However, insurance finance income and expenses on insurance contracts would be required to be presented above such a subtotal, within operating profit.
- 56. A few Board members questioned whether the presentation of interest expenses on financial debt below the 'profit before financing and income tax' subtotal would provide useful information about insurers:
  - (a) they questioned whether, similar to banks, insurers' operating and treasury/financing activities may be closely linked, so it may be more appropriate to present expenses from financing activities within operating profit; and
  - (b) in their experience, insurers will often only have a limited amount of expenses from financing activities. Such a subtotal may therefore be very

close to profit before income tax and clutter the statement(s) of financial performance.

57. Board members asked the staff to perform further research and outreach on this issue.

*Staff analysis*

58. The staff conducted outreach with three insurance analysts. All analysts expressed the view that insurers' expenses on financial debt should be presented outside operating profit, because they believe:

- (a) compared to banks, there is a clearer distinction between insurers' operating activities and treasury/financing activities.
- (b) insurers' financial debt typically serves a different purpose than for banks. Insurers primarily issue debt with loss-absorbing capacity (eg hybrid debt) as a buffer for regulatory capital purposes and generally do not use these funds to generate a net interest margin. The role of insurers' financial debt is generally not to fund their day-to-day working capital requirements.

59. We therefore think that that insurers' expenses on financial debt are not generally considered to be part of their key operating performance metric(s).

60. In addition, the staff has looked at the financial statements and other reporting materials of 10 large insurers applying IFRS Standards. We found that:

- (a) two entities presented an operating profit subtotal in their statement(s) of financial performance that excludes the interest expense on financial debt. This presentation is in line with the illustrative template for insurers issued by the accounting standard-setter in their jurisdiction.<sup>12</sup>
- (b) the other eight entities did not present an operating profit subtotal in their statement(s) of financial performance. Interest on financial debt was usually presented as a separate line item, listed together with other types of expenses.

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<sup>12</sup> Available at

[http://www.anc.gouv.fr/files/live/sites/anc/files/contributed/ANC/2.%20Normes%20internationales/NI%202013/Recommandation\\_2013\\_R05.pdf](http://www.anc.gouv.fr/files/live/sites/anc/files/contributed/ANC/2.%20Normes%20internationales/NI%202013/Recommandation_2013_R05.pdf)

- (c) of the eight entities that did not present an operating profit subtotal in their statement(s) of financial performance, six did present an operating profit subtotal outside their financial statements. The interest on financial debt was included in operating profit in three cases and was excluded in the other three cases.
61. In addition, applying the concept of materiality, insurers with immaterial expenses from financing activities, income from cash and cash equivalents<sup>13</sup> and expenses from the unwinding of a discount (on liabilities other than insurance contract liabilities) would not be required to present a ‘profit before financing and tax’ subtotal. In our view, this addresses the concern in paragraph 56(b).
62. While our review of financial statements is inconclusive, the feedback received from user outreach confirms the Board’s tentative decision. The staff do not think there is evidence of new information and therefore we do not think the Board should reconsider its tentative decision on this topic.

**Question 3**

Does the Board have any comments or questions about the staff analysis in paragraphs 58–62?

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<sup>13</sup> We are planning to discuss at a future Board meeting whether insurers should include income from cash and cash equivalents in operating profit—see paragraph 13(a).

## **Appendix A—Tentative Board decisions on subtotals for non-financial entities**

- A1. In response to requests from users for more comparable subtotals in the statement(s) of financial performance, the Board has tentatively decided to require the following three subtotals in the statement(s) of financial performance for non-financial entities:
- (a) operating profit;
  - (b) operating profit and share of profit of integral associates and joint ventures;  
and
  - (c) profit before financing and income tax.
- A2. The Board has tentatively decided to define these subtotals by describing which items are excluded from profit or loss.
- A3. The Board has tentatively decided non-financial entities would be required to include the following items in the financing section below the profit before financing and income tax subtotal:
- (a) interest income from cash and cash equivalents calculated using the effective interest method;
  - (b) other income from cash, cash equivalents and financing activities;
  - (c) expenses from financing activities;
  - (d) other finance income (for example, unwinding of a discount on a defined benefit asset); and
  - (e) other finance expenses (ie unwinding of a discount on liabilities not arising from financing activities).
- A4. The Board tentatively decided to describe ‘financing activities’ as involving:
- (a) the receipt or use of a resource from a provider of finance (or provision of credit).
  - (b) the expectation that the resource will be returned to the provider of finance.
  - (c) the expectation that the provider of finance will be appropriately compensated through the payment of a finance charge. The finance charge is dependent on both the amount of the credit and its duration.

- A5. The Board has tentatively decided non-financial entities would be required to present ‘income and expenses from investments’ between the ‘operating profit and share of profit of integral associates and joint ventures’ subtotal and the ‘profit before financing and income tax’ subtotal. The Board has tentatively defined ‘income and expenses from investments’ as ‘income/expenses from assets that generate a return individually and largely independently of other resources held by the entity’. The Board has tentatively decided to provide a list of some items that would typically be treated as ‘investing’ and a list of some items that would typically not be treated as ‘investing’.

## **Appendix B—Extract from September 2018 IASB Update**

- B1. The Board discussed:
- (a) the scope of the Board’s proposal for a ‘profit before finance income/expenses and income tax’ subtotal;
  - (b) the scope of the Board’s proposal for a ‘profit before income/expenses from investments, finance income/expenses and income tax’ subtotal;
  - (c) the implications of the scope proposals for the presentation of subtotals by entities with more than one main business activity; and
  - (d) the implications of the scope proposals for the presentation of the share of profit from investments in associates and joint ventures.
- B2. The Board tentatively agreed in principle with the proposed requirements relating to (a)–(c) above but directed the staff to improve the proposals by:
- (a) redrafting and reordering to simplify and clarify the proposals; and
  - (b) developing better ways to describe entities that are not required to provide some of the proposed subtotals.

### ***The scope of the Board’s proposal for a ‘profit before finance income/expenses and income tax’ subtotal***

- B3. The Board tentatively decided in principle that:
- (a) entities are not required to present a ‘profit before finance income/expenses and income tax’ subtotal if their main business activity is to provide financing to customers and if they separately present financing income. Eleven of 14 Board members agreed and three disagreed with this decision.
  - (b) entities that do not present a ‘profit before finance income/expenses and income tax’ subtotal shall include in the ‘business profit from consolidated entities’ subtotal:
    - (i) interest income on cash and cash equivalents calculated using the effective interest method;

- (ii) other income from cash and cash equivalents and financing activities; and
- (iii) expenses from financing activities.

Eleven of 14 Board members agreed and three disagreed with this decision.

- (c) entities with insurance finance income or expenses should include it in the ‘business profit from consolidated entities’ subtotal. (Applying the proposals in the section on the scope of the Board’s proposal for a ‘profit before income/expenses from investments, finance income/expenses and income tax’ subtotal, related investment income and expenses would also be included in that subtotal.) Twelve of 14 Board members agreed and two disagreed with this decision.

***The scope of the Board’s proposal for a ‘profit before income/expenses from investments, finance income/expenses and income tax’ subtotal***

B4. The Board tentatively decided in principle that:

- (a) entities are not required to present a ‘profit before income/expenses from investments, finance income/expenses and income tax’ subtotal if, in the course of their main business activity, they invest in assets that generate a return individually and largely independently from other resources held by the entity. Thirteen of 14 Board members agreed and one disagreed with this decision.
- (b) entities that do not present a ‘profit before income/expenses from investments, finance income/expenses and income tax’ subtotal shall include income/expenses from investments made in the course of their main business activity within the ‘business profit from consolidated entities’ subtotal and below that subtotal present all other income/expenses from investments. Twelve of 14 Board members agreed and two disagreed with this decision.

***The implications of scope proposals for the presentation of subtotals by entities with more than one main business activity***

- B5. The Board tentatively decided in principle that entities whose main business activities comprise investing and providing financing to customers are:
- (a) not required to present a ‘profit before finance income/expenses and income tax’ subtotal and shall include, within the ‘business profit from consolidated entities’ subtotal, the following line items:
    - (i) interest income on cash and cash equivalents calculated using the effective interest method;
    - (ii) other income from cash and cash equivalents and financing activities; and
    - (iii) expenses from financing activities.
  - (b) not required to present a ‘profit before income/expenses from investments, finance income/expenses and income tax’ subtotal and shall include income/expenses from investments made in the course of their investing business activity within the ‘business profit from consolidated entities’ subtotal and below that subtotal, present all other income/expenses from investments.

Thirteen of 14 Board members agreed and one disagreed with this decision.

- B6. The Board discussed, but did not reach a tentative decision about entities whose main business activities include a non-financial business activity and also include investing or providing financing to customers (or both). The Board indicated that such entities should not be exempt from presenting the ‘profit before finance income/expenses and income tax’ subtotal or the ‘profit before income/expenses from investments, finance income/expenses and income tax’ subtotal. Instead, such entities should be permitted or required to include some income or expenses from financing activities or investing activities in the ‘business profit from consolidated entities’ subtotal. The Board asked the staff to develop this proposal further and consider whether the approach used for such entities could be used to simplify the proposals for other entities.

***The implications of the scope proposals for the presentation of the share of profit from investments in associates and joint ventures***

- B7. The Board tentatively decided that all entities are required to separately present the share of profit or loss from integral and non-integral associates and joint ventures below the ‘business profit from consolidated entities’ subtotal. All 14 Board members agreed with this decision.

### Appendix C—Comparison of staff proposals in this paper with September 2018 staff proposals

		Expenses from financing activities and income from cash & cash equivalents		Income (expenses) from investments		
		September 2018	February 2019	September 2018	February 2019	
		<b>Blue shading = difference in approach (outcome for an individual entity could be the same, depending on its accounting policy choice)</b>				
One main activity	1	General corporates	All below operating profit	All below operating profit	All below operating profit	All below operating profit
	2	Entities whose only main business activity is providing financing to customers (eg traditional banks)	All above operating profit <b>OR</b> All below operating profit	Split: Related to provision of financing to customers above operating profit; rest below <b>OR</b> all above operating profit	All below operating profit	All below operating profit
	3	Entities who invest in the course of their only main business activity (eg investment property companies & insurers)	All below operating profit (except insurance finance expense/ income above operating profit)	All below operating profit (except insurance finance expense/ income above operating profit)	Split: In course of main business activity above operating profit; rest below <b>OR</b> all below operating profit	Split: In course of main business activity above operating profit; rest below
Multiple main activities	4	Entities whose main business activities only comprise investing and provision of financing to customers (eg universal banks)	All above operating profit <b>OR</b> All below operating profit	Split: Related to provision of financing to customers above operating profit; rest below <b>OR</b> All above operating profit	Split: In course of main business activity above operating profit; rest below <b>OR</b> all below operating profit	Split: In course of main business activity above operating profit; rest below
	5	Entities whose main business activities comprise both a non-financial main business activity and provision of financing to customers	Split: Related to provision of financing to customers above operating profit; rest below <b>OR</b> All below operating profit	Split: Related to provision of financing to customers above operating profit; rest below <b>OR</b> All above operating profit	All below operating profit	All below operating profit
	6	Entities whose main business activities comprise both a non-financial main business activity and investing	All below operating profit	All below operating profit	Split: In course of main business activity above operating profit; rest below <b>OR</b> all below operating profit	Split: In course of main business activity above operating profit; rest below
	7	Entities whose main business activities comprise a non-financial main business activity, provision of financing to customers and investing	Split: Related to provision of financing to customers and investing above operating profit; rest below <b>OR</b> All below operating profit	Split: Related to provision of financing to customers above operating profit; rest below <b>OR</b> All above operating profit	Split: In course of main business activity above operating profit; rest below <b>OR</b> all below operating profit	Split: In course of main business activity above operating profit; rest below

## STAFF PAPER

February 2019

## IASB® meeting

Project	Primary Financial Statements		
Paper topic	Outstanding issues on the statement of cash flows		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

**Purpose of this paper**

1. This paper discusses two issues relating to the statement of cash flows:
  - (a) Issue 1: amending the Board's tentative decision on the starting point for the indirect reconciliation of operating cash flows to reflect the Board's recent tentative decisions on subtotals; and
  - (b) Issue 2: applying the Board's tentative decision to remove options for the classification of cash flows from interest and dividends to financial entities.
2. By financial entities, we mean entities that provide financing to customers as a main business activity and/or invest in the course of their main business activities in assets that generate a return individually and largely independently of other resources held by the entity.

**Summary of staff recommendations**

3. The staff recommend that the starting point for the indirect reconciliation of operating cash flows should be the operating profit subtotal, for all entities (this recommendation amends the Board's December 2017 tentative decision).
4. In addition, the staff recommend that:
  - (a) all entities shall classify:

- (i) cash flows from dividends paid as financing cash flows; and
  - (ii) cash flows from dividends received from equity-accounted associates and joint ventures as investing cash flows;
- (b) entities that provide financing to customers as a main business activity and/or invest in the course of their main business activities in assets that generate a return individually and largely independently of other resources held by the entity, shall classify each of cash flows from dividends received, interest paid and interest received in a single section of the statement of cash flows; and
- (c) such entities shall determine the section in which to classify each of cash flows as follows:
  - (i) if the entity presents the related income/expenses in a single section of the statement(s) of financial performance, the entity shall present related cash flows in that section; or
  - (ii) if the entity presents related income/expenses in more than one section of the statement(s) of financial performance, the entity shall make an accounting policy choice regarding the section of the statement of cash flows in which to present related cash flows.

## Overview

- 5. The paper is structured as follows:
  - (a) Background including previous Board decisions (paragraphs 6–13)
    - (i) tentative decisions on elimination of classification options for non-financial entities (paragraphs 8–10)
    - (ii) tentative decisions on scope of subtotals in the statement(s) of financial performance for financial entities and new proposals in AP21A (paragraphs 11–13)
  - (b) Issue 1: the starting point for the indirect reconciliation of operating cash flows (paragraphs 14–20)
  - (c) Issue 2: applying the Board’s tentative decisions to remove classification options in the statement of cash flows to financial entities

- (i) staff approach (paragraphs 21–24)
  - (ii) which of the Board decisions on classification of cash flows from interest and dividends can apply to all entities? (paragraph 25)
  - (iii) what amendments should the Board make for financial entities? (paragraphs 26–46)
  - (iv) staff recommendation (paragraph 47)
- (d) Appendix A: illustration of different starting points for the indirect reconciliation of operating cash flows
- (e) Appendix B: illustration of expected effects of Approaches A and B

## Background

6. The Board has tentatively decided to make limited changes to the statement of cash flows as part of the project. Those changes are to:
- (a) eliminate options for the classification of cash flows from interest and dividends in the statement of cash flows; and
  - (b) require a consistent starting point for the indirect reconciliation of cash flows.
7. The Board considered but tentatively decided not to align the operating section of the statement of cash flows with a corresponding section in the statement(s) of financial performance.

### ***Tentative decisions on elimination of classification options for non-financial entities***

8. Paragraphs 33 and 34 of IAS 7 *Statement of Cash Flows* allow entities to choose how to classify cash flows arising from interest and dividends as shown in the table below:

Cash flow item	IAS 7 classification
Interest paid	Operating or financing
Dividends paid	Operating or financing
Interest received	Operating or investing
Dividends received	Operating or investing

9. The Board tentatively decided to remove these classification options for non-financial entities and require that the cash flows are classified as shown in the table below:<sup>1</sup>

Cash flow item	Classification per Board's tentative decisions
Interest paid	Financing
Dividends paid	Financing
Interest received	Investing
Dividends received	Investing

10. For non-financial entities, the Board also tentatively decided that investing cash flows, such as dividends received, arising between an entity and its equity-accounted investees should be classified as investing cash flows in the statement of cash flows. In addition, investing cash flows from/to integral associates and joint ventures would be presented separately from cash flows from/to non-integral associates and joint ventures.<sup>2</sup>

***Tentative decisions on scope of subtotals in the statement(s) of financial performance for financial entities and new proposals in AP21A***

11. In September 2018, the Board tentatively decided to permit (or require) some entities to include interest income/expenses and investment income/expenses within the operating profit subtotal.
12. In Agenda Paper 21A for this meeting, the staff are proposing to redraft the model for financial entities discussed in September 2018 to reflect the Board's comments and suggestions made during those discussions. The new proposals are as follows:
- (a) an entity that provides financing to customers as a main business activity is required to include in operating profit either:
- (i) expenses from financing activities and income from cash and cash equivalents relating to its financing business activity; or
- (ii) all expenses from financing activities and income from cash and cash equivalents.

<sup>1</sup> See [AP21C December 2017](#) and the [December 2017 IASB Update](#).

<sup>2</sup> See [AP21C February 2018](#) and the [February 2018 IASB Update](#).

- (b) an entity that, in the course of its main business activities, invests in assets that generate a return individually and largely independently of other resources held by the entity is required to include in operating profit, income (expenses) from investments made in the course of its main business activities.
  - (c) an entity that provides financing to customers as a main business activity shall not present the ‘profit before financing and income tax’ subtotal if the entity does not present expenses from financing activities and income from cash and cash equivalents below operating profit. This exception applies even when such an entity presents in the statement(s) of financial performance the unwinding of a discount on liabilities that do not arise from financing activities.
13. Our analysis and recommendations in this paper are based on these new proposals in Agenda Paper 21A.

### **Issue 1: The starting point for the indirect reconciliation of operating cash flows**

14. Paragraph 20 of IAS 7 states that, applying the indirect method, the net cash flow from operating activities is determined by adjusting *profit or loss*; however, we observed variation in the starting point that entities use for determining operating cash flows in the statement of cash flows.<sup>3</sup>
15. In December 2017, the Board tentatively decided to require the subtotal ‘profit before investing, financing, and income tax’ as the consistent starting point for the indirect reconciliation of cash flows from operating activities.
16. However, subsequent Board decisions have changed the content of that subtotal. The Board has tentatively decided to:
- (a) present separately above the ‘profit before investing, financing, and income tax’ subtotal the share of results from integral associates and joint ventures.

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<sup>3</sup> Refer to paragraphs 52–58 of [AP21A November 2016](#).

This decision created an additional subtotal above the share of results from integral associates and joint ventures.

- (b) describe this additional subtotal as ‘operating profit’.
17. The subtotal that the Board previously decided as the starting point of the reconciliation is now described as ‘operating profit and share of profit or loss of integral associates and joint ventures’.

### ***Staff analysis and recommendation***

18. Appendix A illustrates the indirect reconciliation of operating cash flows using two different starting points—the ‘operating profit’ subtotal and the ‘operating profit and share of profit or loss of integral associates and joint ventures’ subtotal.
19. The staff think that the operating profit subtotal is a more appropriate starting point for the indirect reconciliation of operating cash flows than ‘operating profit and share of profit or loss of integral associates and joint ventures’, because:
- (a) the reconciliation will be more straightforward, without the need to adjust for share of profit from equity accounted investees; and
  - (b) the reconciliation will be easier to understand, providing a link between operating profit and cash flows from operating activities.
20. As all entities will be required to present an operating profit subtotal, the staff think that this recommendation can apply equally to all entities (both financial entities and non-financial entities).

#### **Question 1**

- (a) Does the Board agree that operating profit should be required as the starting point for the indirect reconciliation of operating cash flows?
- (b) Does the Board agree that this requirement should apply to all entities?

## **Issue 2: Applying the Board's tentative decisions to remove classification options in the statement of cash flows to financial entities**

### ***Staff approach***

21. In making tentative decisions to remove classification options for interest and dividends in the statement of cash flows for non-financial entities, the Board considered the location of the related income and expenses in the statement(s) of financial performance. For example, in deciding that dividends received from investments should be presented in the investing section of the statement of cash flows, the Board noted that, for general corporates, dividend income from investments would be classified in the investing section of the statement(s) of financial performance.
22. The location of interest income or expenses and dividend income in the statement(s) of financial performance for financial entities is different from the location of those income and expenses for non-financial entities. Consequently, this paper discusses how financial entities should classify the related cash flows.
23. We acknowledge that some users of financial statements have said that the statement of cash flows does not provide useful information about the cash flows of some financial entities (for example, banks). However, as discussed in paragraphs 6–7, the Board has tentatively decided to make only limited changes to the statement of cash flows in this project. Consequently, this paper does not fundamentally reconsider the role or the structure of the statement of cash flows for financial entities.
24. The staff have considered:
  - (a) which of the Board decisions on classification of cash flows from interest and dividends can apply to all entities (see paragraph 25); and
  - (b) what amendments to the Board's decisions are needed for financial entities (see paragraphs 26–46).

***Which of the Board decisions on classification of cash flows can apply to all entities?***

25. The staff think the following tentative decisions can apply to all entities:
- (a) classification of cash flows from dividends paid as financing cash flows.  
This is because, for both financial and non-financial entities, dividends paid are a distribution of profits to the providers of capital and hence should be considered as a financing cash flow.
  - (b) classification of dividends received from equity-accounted associates and joint ventures as investing cash flows. This is consistent with the proposals for the structure of the statement(s) of financial performance where the share of results of equity-accounted investees are excluded from the operating profit subtotal of both financial and non-financial entities.

**Question 2**

Does the Board agree with the staff recommendation that all entities should classify:

- (a) cash flows from dividends paid as financing cash flows; and
- (b) cash flows from dividends received from equity-accounted associates and joint ventures as investing cash flows?

***What amendments should the Board make for financial entities?***

26. The staff think the Board's tentative decisions on classification of interest received, interest paid, and dividends received (from non-equity accounted investees) may need to be modified for financial entities. Applying the proposals for classification in the statement(s) of financial performance for financial entities, some financial entities will present most, or all, of their interest income, interest expenses and/or dividend income in the operating profit section of the statement(s) of financial performance. The staff think it would be counter-intuitive and inconsistent with the Board's approach for

financial entities in the statement(s) of financial performance, if all cash flows relating to interest income, interest expenses and/or dividend income are presented below the operating section of the statement of cash flows for financial entities.

27. We have considered two possible approaches for financial entities:
- (a) Approach A ('aligned' approach): align the classification of interest and dividends in the statement of cash flows with the presentation of the related income or expenses in the statement(s) of financial performance; and
  - (b) Approach B ('single' approach): require each type of interest and dividend cash flow to be presented in a single section of the statement of cash flows.

*Approach A (aligned approach)*

28. Applying approach A, financial entities would align the classification of interest and dividend items in the statement of cash flows with the presentation of the related income or expenses in the statement(s) of financial performance.
29. Table 1 in Appendix B illustrates the expected classification of cash flows applying approach A for different types of financial entity.
30. In summary, the effect of this approach is that:
- (a) cash flows from interest received (except for interest received from cash and cash equivalents—see paragraph 30(c) below) would be:
    - (i) split between the operating and the investing sections by entities that provide financing to customers as a main business activity and/or invest in debt securities in the course of their main business activity, plus also invest in other debt securities; or
    - (ii) presented in the operating section by entities that invest in debt securities in the course of their main business activity, and/or provide finance to customers as their main business activity, and do not have other investments in debt securities; or
    - (iii) presented in the investing section by entities that do not provide financing to customers nor invest in debt instruments in the course of their main business activity.

- (b) cash flows from dividends received from non-equity accounted investments would be:
    - (i) split between the operating and the investing sections by entities that invest in non-equity accounted equity instruments in the course of their main business activity, plus invest in other equity instruments; or
    - (ii) presented in the operating section by entities that invest in non-equity accounted equity instruments in the course of their main business activity, and have no other investments in equity instruments; or
    - (iii) presented in the investing section by entities that do not invest in non-equity accounted equity instruments in the course of their main business activity.
  - (c) cash flows from interest paid and cash flows from interest received on cash and cash equivalents would be:
    - (i) in the financing section, for entities that do not provide financing to customers as a main business activity; or
    - (ii) in the operating section, or split between the operating and financing section, for entities that provide financing to customers as a main business activity, depending on whether they elect to split related expenses and income or move them all up to the operating profit (refer to proposals in AP21A).
31. The advantage of this approach is that the location of cash flows from interest and dividends in the statement of cash flows is aligned with the location of related income and expenses in the statement(s) of financial performance, meaning that it will be relatively easy for the users of financial statements to identify which cash flows relate to which items of income and expenses.
32. In some cases, this approach would be consistent with current practice—cash flows would be presented in a single section of statement of cash flows. However, in other cases this approach would be inconsistent with current practice as cash flows would be split between the sections of the statement of cash flows.
33. Applying this approach, financial entities would use the same basis for allocation of cash flows between sections in the statement of cash flows as they use for allocation

of income or expenses in the statement of financial performance (ie this approach highlights the relationship between these two statements). In outreach, users have supported approaches that highlight the relationships between the primary financial statements. However, users have also told us they want to see each type of interest and dividend cash flow in a single location, which this approach does not achieve.

34. If a financial entity's accounting system is capable of allocating income and expenses to different sections of the statement(s) of financial performance, it may also be capable of allocating the related cash flows. In such situations, this approach may not be costly to apply. However, this may not always be the case. Consequently, it is not clear whether the benefits of this approach would justify potential costs, given that users of financial statements generally do not make much use of the statement of cash flows for financial entities.

*Approach B (single approach)*

35. Applying approach B, financial entities would classify each type of cash flow (dividends received, interest paid and interest received) in a single section of the statement of cash flows, even if related income and expenses are in multiple sections in the statement(s) of financial performance.
36. Approach B is similar to the Board's approach to non-financial entities, in that it allocates each type of cash flow to a single section of the statement of cash flows.
37. This approach is also similar to current practice in which entities include each type of cash flow in a single section of the statement of cash flows.
38. However, Approach B would not result in alignment of the classification of interest and dividends between the statement(s) of financial performance and the statement of cash flows.
39. One consequence of this misalignment is that when using the indirect method of reconciliation (assuming the entities would use operating profit as the starting point, as proposed in this paper), entities might need to present additional reconciling items to arrive at net cash from operating activities. For example, let's assume an investment entity classifies dividends received as operating cash flows and this entity also holds investments in equity instruments not made in the course of its main business activity. Income from these investments would be presented below

operating profit. Thus, cash received from dividends for these investments would be an additional reconciling item in the operating section of the statement of cash flows.

*How to determine which single section entities should use?*

40. The staff have considered two ways to determine in which single section of the statement of cash flows to present each type of cash flows:
- (a) Variant 1: based on which section in the statement(s) of financial performance *most* of the related income/expenses is included.
  - (b) Variant 2:
    - (i) if an entity presents related income/expenses in a single section of the statement(s) of financial performance, the entity shall present related cash flows in that section; and
    - (ii) if an entity presents related income/expenses in more than one section of the statement(s) of financial performance, the entity shall make *an accounting policy choice*<sup>4</sup> regarding which section of the statement of cash flows to present the related cash flows.
41. Applying variant 1, different outcomes are possible for a financial entity. For example, an investing entity may be required to classify interest received as either an operating or investing cash flow, depending on whether the entity, in the course of its main business activity, invests in interest-bearing assets and what proportion of its investing activities relate to interest-bearing assets.
42. Variant 1 relies on a comparison of the relative size of income and expenses in different sections of the statement(s) of financial performance and might result in entities allocating the same types of cash flows to different sections in the statement of cash flows in different reporting periods.
43. This potential variability of outcomes from period to period and somewhat rule-based nature of variant 1 are its main disadvantages.
44. Both variants result in alignment between the statement of cash flows and the statement(s) of financial performance in situations where an entity presents the

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<sup>4</sup> Such choice would be treated as an accounting policy as defined by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and disclosed in accordance with paragraph 117 of IAS 1.

income/expense in a single section of the statement(s) of financial performance.

However, in situations where the income/expense is included in more than one section of the statement of financial performance, there is no alignment between the statement of cash flows and the statement(s) of financial performance.

45. Variant 2 of approach B does not fully achieve the Board's objective of eliminating classification options in the statement of cash flows. It however reduces those options to instances in which related income/expenses are presented in more than one section of the statement(s) of financial performance. We think these instances would be most common for presentation of interest paid, for entities that both provide financing to customers and have other business activities giving rise to expenses from financing (and do not elect to present them all in the operating profit, as per option proposed in AP21A for this meeting).
46. Table 2 in Appendix B illustrates the expected classification of cash flows applying variant 2 of approach B for different types of financial entity.

### ***Staff recommendation***

47. The staff think the benefits of the single approach discussed in paragraph 35 outweigh its disadvantages, and that variant 2 of the approach is preferable, even though it provides an accounting policy choice in some instances. Our main reasons for recommending this approach are as follows:
  - (a) it achieves some alignment between the statement(s) of financial performance and the statement of cash flows.
  - (b) it results in a simpler presentation of cash flows in that each type of cash flow is in a single section of the statement of cash flows.
  - (c) this simpler presentation is consistent with current practice and consistent with the Board's proposed approach for non-financial entities (although presentation outcomes could be different between financial and non-financial entities).
  - (d) some users of financial statements have said that the statement of cash flows does not provide useful information about the cash flows of some financial entities. However, comprehensively reconsidering the structure

and content of the statement of cash flows is outside the scope of this project. Consequently, we think that a simple approach that is consistent with current practice is desirable until such time that the Board decides to comprehensively address the statement of cash flows for financial entities.

**Question 3**

Does the Board agree with the staff recommendation that:

- (a) entities that provide financing to customers as a main business activity and/or invest in the course of their main business activity in assets that generate a return individually and largely independently of other resources held by the entity, shall classify each of cash flows from dividends received, interest paid and interest received in a single section of the statement of cash flows; and
- (b) such entities shall determine the section in which to classify each of cash flows as follows:
  - (i) if the entity presents the related income/expenses in a single section of the statement(s) of financial performance, the entity shall present related cash flows in that section; or
  - (ii) if the entity presents related income/expenses in more than one section of the statement(s) of financial performance, the entity shall make an accounting policy choice regarding the section of the statement of cash flows in which to present related cash flows.

## Appendix A — Illustration of different starting points for the indirect reconciliation of operating cash flows

### Starting point: Operating profit

<b>Cash flows from operating activities</b>	
<b>Operating profit</b>	3,290
<i>Adjustments for:</i>	
Depreciation	450
	<u>3,740</u>
<i>Movements in working capital</i>	
Increase in trade and other receivables	(500)
Decrease in inventories	1,050
Decrease in trade payables	<u>(1,740)</u>
Cash generated from operations	2,550
Income taxes paid	<u>(900)</u>
<i>Net cash from operating activities</i>	1,650

### Starting point: Operating profit and share of profit from integral associates and joint ventures

<b>Cash flows from operating activities</b>	
<b>Operating profit and share of profit from integral associates and joint ventures</b>	3,390
<i>Adjustments for:</i>	
Depreciation	450
Share of profit from integral associates and joint ventures	<u>(100)</u>
	3,740
<i>Movements in working capital</i>	
Increase in trade and other receivables	(500)
Decrease in inventories	1,050
Decrease in trade payables	<u>(1,740)</u>
Cash generated from operations	2,550
Income taxes paid	<u>(900)</u>
<i>Net cash from operating activities</i>	1,650

**Appendix B — illustration of expected effects of approaches A and B**

*Table 1— expected effect of Approach A: aligned approach*

		Interest paid & Interest received from cash and cash eq.		Interest received from customers	Interest received from investments & Dividends received from non-equity accounted investees	
	1	General corporates	Financing for interest paid	Investing for interest received from cash and cash equivalents	Investing	Investing
One main activity	2	Entities whose only main business activity is providing financing to customers (eg traditional banks)	Split: <b>operating</b> if related to provision of financing to customers; if not, financing <b>OR</b> all operating		<b>Operating</b>	Investing
	3	Entities who invest in the course of their only main business activity (eg investment property companies & insurers)	Financing		<b>Operating (rare)</b>	Split: <b>operating</b> if related to main business activity; if not, investing
	4	Entities whose main business activities comprise both investing and provision of financing to customers (eg universal banks)	Split: <b>operating</b> if related to provision of financing to customers; if not, financing <b>OR</b> all operating		<b>Operating</b>	Split: <b>operating</b> if related to main business activity; if not, investing
Multiple main activities	5	Entities whose main business activities comprise both a non-financial main business activity and provision of financing to customers	Split: <b>operating</b> if related to provision of financing to customers; if not, financing <b>OR</b> all operating		<b>Operating</b>	Investing
	6	Entities whose main business activities comprise both a non-financial main business activity and investing	Financing		<b>Operating (rare)</b>	Split: <b>operating</b> if related to main business activity; if not, investing
	7	Entities whose main business activities comprise a non-financial main business activity, provision of financing to customers and investing	Split: <b>operating</b> if related to provision of financing to customers; if not, financing <b>OR</b> all operating		<b>Operating</b>	Split: <b>operating</b> if related to main business activity; if not, investing

Table 2 — expected effect of Variant 2 of Approach B: single approach based on accounting policy choice when not aligned

		Interest paid	Interest received	Dividends received from non-equity accounted investees	
	1	General corporates	Financing	Investing	Investing
One main activity	2	Entities whose only main business activity is providing financing to customers (eg traditional banks)	If entity uses proposed exemption in AP21A=> <b>Operating</b> <b>OR</b> If entity does not use proposed exemption in AP21A => <b>Accounting policy choice (Note 1): operating or financing</b>	<b>Accounting policy choice (Note 2): operating or investing</b>	<b>Investing</b>
	3	Entities who invest in the course of their only main business activity (eg investment property companies & insurers)	<b>Financing</b>	<b>Accounting policy choice (Note 3): operating, investing or financing</b>	<b>Accounting policy choice (Note 4): operating or investing</b>
Multiple main activities	4	Entities whose main business activities comprise both investing and provision of financing to customers (eg universal banks)	Same as for entity 2	If entity uses proposed exemption in AP21A=> same as for entity 2 <b>OR</b> If entity uses does not use proposed exemption in AP21A=> same as for entity 3	Same as for entity 3
	5	Entities whose main business activities comprise both a non-financial main business activity and provision of financing to customers		Same as for entity 2	
	6	Entities whose main business activities comprise both a non-financial main business activity and investing		Same as for entity 3	
	7	Entities whose main business activities comprise a non-financial main business activity, provision of financing to customers and investing		Same as for entity 4	

Note 1: assuming entity has both interest paid on financing activities to fund provision of financing to customers, and interest paid on other financing activities

Note 2: assuming entity has both interest received from providing financing in main business activity, and interest received from other investments

Note 3: assuming entity has more than one of the following: interest received from providing financing in main business activity; interest from other investments, interest from cash and cash equivalents

Note 4: assuming entity has both dividends received from investments made in main business activities, and dividends received from other investment

## STAFF PAPER

February 2019

## IASB® Meeting

<b>Project</b>	<b>Primary Financial Statements</b>		
<b>Paper topic</b>	Cover note and summary of the Board's tentative decisions		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB *Update*.

**Papers for this meeting**

1. **Agenda Paper 21A—Classification of income and expenses by financial entities:** this paper addresses some Board members' comments on the scope of proposals for required subtotals in the statement(s) of financial performance and further refines the proposals.
2. **Agenda Paper 21B—Outstanding issues on the statement of cash flows:** this paper discusses two issues relating to the statement of cash flows: (1) amending the tentative decisions on the starting point for the indirect reconciliation of operating cash flows and (2) removing options for classification of cash flows from interest and dividends for financial entities.
3. **Agenda Paper 21C—Additional proposals on aggregation and disaggregation:** this paper further develops the guidance supporting aggregation and disaggregation of information in the primary financial statements and in the notes.

**Next steps**

4. At future Board meetings, we plan to discuss:
  - a. outstanding issues relating to application of project proposals to financial entities;
  - b. outstanding issues relating to unusual or infrequent items;

- c. feedback received on some aspects of the project proposals; and
  - d. which type of consultative document to publish to obtain feedback on the Board's tentative decisions.
5. Depending on the Board's decision on the consultative document, there could be additional topics for the Board to discuss.
6. The Appendix includes a summary of the Board's tentative decisions to date in the project.

## Appendix A: Summary of the Board’s tentative decisions to date in the project

Topic	Staff condensed summary of Board's tentative decisions
	<i>A full record of the Board's tentative decisions is available from the December 2016-December 2018 IASB updates.</i>
<b>General</b>	<p>The Board tentatively decided to focus on targeted improvements to the statement(s) of financial performance and to the statement of cash flows.</p> <p>In September 2018, the Board decided to move the project to its standard-setting agenda. The Board will decide at a later stage of the project whether to issue a Discussion Paper or an Exposure Draft as the first due process output of the project.</p>
<b>Statement(s) of financial performance—project scope</b>	<p>The Board tentatively decided to explore the following topics in this project:</p> <ul style="list-style-type: none"> <li>a. requiring additional subtotal(s) in the statement(s) of financial performance;</li> <li>b. removing some of the options for presentation of income and expenses in existing IFRS Standards (eg presentation of net interest cost on the net defined benefit liability);</li> <li>c. providing guidance on use of performance measures, including separate presentation of non-recurring, unusual or infrequently occurring items; and</li> <li>d. better ways to communicate information about other comprehensive income (OCI).</li> </ul> <p>The Board tentatively decided to prioritise introducing into the statement(s) of financial performance subtotals that facilitate comparisons between entities, such as profit before financing activities, over introducing a management-performance measure subtotal.</p> <p>.</p>
<b>Statement(s) of financial performance—financing activities</b>	<p>The Board agreed to explore:</p> <ul style="list-style-type: none"> <li>a. requiring the presentation of an EBIT-type subtotal in the statement(s) of financial performance; and</li> <li>b. describing the subtotal as profit before financing and income tax.</li> </ul> <p>The Board tentatively decided that the category below this subtotal should consist of the following separate line items in the statement(s) of financial performance:</p> <ul style="list-style-type: none"> <li>a. 'interest income from cash and cash equivalents calculated using the effective interest method';</li> <li>b. 'other income from cash, cash equivalents and financing activities'; and</li> <li>c. 'expenses from financing activities'</li> </ul> <p>'Cash and cash equivalents' is used in the definition of 'finance income/expenses' as a proxy for cash and temporary investments of excess cash. The Board also noted that a separate line item for impairment of cash and cash equivalents may be needed, if material.</p>

Topic	Staff condensed summary of Board's tentative decisions
	<p>The Board tentatively decided to clarify the description of 'financing activities' in IAS 7 <i>Statement of Cash Flows</i> by indicating that a financing activity involves:</p> <ul style="list-style-type: none"> <li>a. the receipt or use of a resource from a provider of finance (or provision of credit).</li> <li>b. the expectation that the resource will be returned to the provider of finance.</li> <li>c. the expectation that the provider of finance will be appropriately compensated through the payment of a finance charge. The finance charge is dependent on both the amount of the credit and its duration.</li> </ul> <p>The Board tentatively decided that 'interest' income/expenses on liabilities that do not arise from financing activities (unwinding of a discount) should also be in this category, even though they do not meet the proposed definition of expenses from financing activities.</p>
<b>Statement(s) of financial performance—investing category and operating profit</b>	<p>The Board agreed (by consensus) to explore the introduction of an investing category into the statement(s) of financial performance.</p> <p>The Board tentatively decided:</p> <ul style="list-style-type: none"> <li>a. to relabel the 'investing' category as 'income/expenses from investments'.</li> <li>b. to define 'income/expenses from investments' using a principle-based approach as 'income/expenses from assets that generate a return individually and largely independently of other resources held by the entity'.</li> <li>c. to provide a list of some items that would typically be treated as 'investing' and a list of some items that would typically not be treated as 'investing'.</li> </ul> <p>The Board tentatively decided that:</p> <ul style="list-style-type: none"> <li>a. entities should be required to present the results of 'integral' associates and joint ventures separately from those of 'non-integral' associates and joint ventures.</li> <li>b. the project's first due-process document should: <ul style="list-style-type: none"> <li>i. use the Board's proposed definition of 'income/expenses from investments' as the basis for the split between integral and non-integral investments in associates or joint ventures, and include a non-exhaustive list of indicators that could be used in making this distinction.</li> <li>ii. propose the presentation in the statement(s) of financial performance of the share of profit or loss of integral associates or joint ventures as a line item above the 'income/expenses from investments' category</li> <li>iii. describe the subtotal above share of profit or loss of integral associates and joint ventures as operating profit</li> <li>iv. describe the subtotal that includes share of profit or loss of integral associates and joint ventures as operating profit and share of profit or loss from integral associates and joint ventures</li> <li>v. discuss all of the alternative approaches considered by the Board for presenting the share of the profit or loss of integral associates and joint ventures, both within and outside the 'income/expenses from investments' category, and the Board's reasons for rejecting those approaches.</li> </ul> </li> </ul> <p>The Board suggested that—subject to drafting improvements—the following indicators should be included to help preparers decide whether an associate or joint venture is 'integral':</p> <ul style="list-style-type: none"> <li>a. the existence of integrated lines of business across the entity and the associate or joint venture that lead to dependency on the associate or joint venture;</li> </ul>

Topic	Staff condensed summary of Board's tentative decisions
	<ul style="list-style-type: none"> <li>b. the associate or joint venture's critical supplier or customer status;</li> <li>c. the reporting entity and the associate's or joint venture's sharing of a name or brand; and</li> <li>d. the sharing of capital or borrowing sources, such that the financing for the entity and the associate or joint venture is interrelated.</li> </ul> <p>In addition, the Board tentatively decided to:</p> <ul style="list-style-type: none"> <li>a. state that the proposed list of indicators should not be prioritised in any way.</li> <li>b. state that the classification of an associate or joint venture as integral or non-integral shall be changed only if the relationship between the reporting entity and the associate or joint venture changes.</li> <li>c. amend the disclosure requirements of IFRS 12 <i>Disclosure of Interests in Other Entities</i> to reflect the introduction of the integral and non-integral categorisation of associates and joint ventures by requiring:               <ul style="list-style-type: none"> <li>i. the disclosure in paragraph 20 to be split between 'integral' and 'non-integral' associates and joint ventures;</li> <li>ii. additional disclosure of the factors considered when determining whether associates and joint ventures are 'integral' or 'non-integral'; and</li> <li>iii. additional disclosure where an equity accounted investment has been reclassified in the period, to indicate how its relationship with the reporting entity has changed.</li> </ul> </li> </ul>
<b>Scope of subtotals</b>	<p>The Board tentatively decided to define the scope of the three proposed subtotals:</p> <ul style="list-style-type: none"> <li>a. profit before financing and income tax.</li> <li>b. operating profit and share of profit or loss from integral associates and joint ventures.</li> <li>c. operating profit.</li> </ul> <p>For the 'profit before financing and income tax' subtotal, the Board tentatively decided in principle that:</p> <ul style="list-style-type: none"> <li>a. entities are not required to present a 'profit before financing and income tax' subtotal if their main business activity is to provide financing to customers and if they separately present financing income.</li> <li>b. entities that do not present a 'profit before financing and income tax' subtotal shall include in the 'operating profit' subtotal:               <ul style="list-style-type: none"> <li>i. interest income on cash and cash equivalents calculated using the effective interest method;</li> <li>ii. other income from cash and cash equivalents and financing activities; and</li> <li>iii. expenses from financing activities.</li> </ul> </li> </ul>

Topic	Staff condensed summary of Board's tentative decisions
	<p>c. entities with insurance finance income or expenses should include it in the 'operating profit' subtotal. (Applying the proposals in the section on the scope of the Board's proposal for an 'operating profit and share of profit or loss from integral associates and joint ventures' subtotal, related investment income and expenses would also be included in that subtotal.)</p> <p>For the 'operating profit and share of profit or loss from integral associates and joint ventures' subtotal, the Board tentatively decided in principle that:</p> <ul style="list-style-type: none"> <li>a. entities are not required to present the subtotal if, in the course of their main business activity, they invest in assets that generate a return individually and largely independently from other resources held by the entity.</li> <li>b. entities that do not present the subtotal shall include income/expenses from investments made in the course of their main business activity within the 'operating profit' subtotal and below that subtotal present all other income/expenses from investments.</li> </ul> <p>The Board tentatively decided in principle that entities whose main business activities comprise investing and providing financing to customers are:</p> <ul style="list-style-type: none"> <li>a. not required to present a 'profit before financing and income tax' subtotal and shall include, within the 'operating profit' subtotal, the following line items:               <ul style="list-style-type: none"> <li>i. interest income on cash and cash equivalents calculated using the effective interest method;</li> <li>ii. other income from cash and cash equivalents and financing activities; and</li> <li>iii. expenses from financing activities.</li> </ul> </li> <li>b. not required to present an 'operating profit and share of profit or loss from integral associates and joint ventures' subtotal and shall include income/expenses from investments made in the course of their investing business activity within the 'operating profit' subtotal and below that subtotal, present all other income/expenses from investments.</li> </ul> <p>The Board tentatively decided that all entities are required to separately present the share of profit or loss from integral and non-integral associates and joint ventures below the 'operating profit' subtotal.</p>

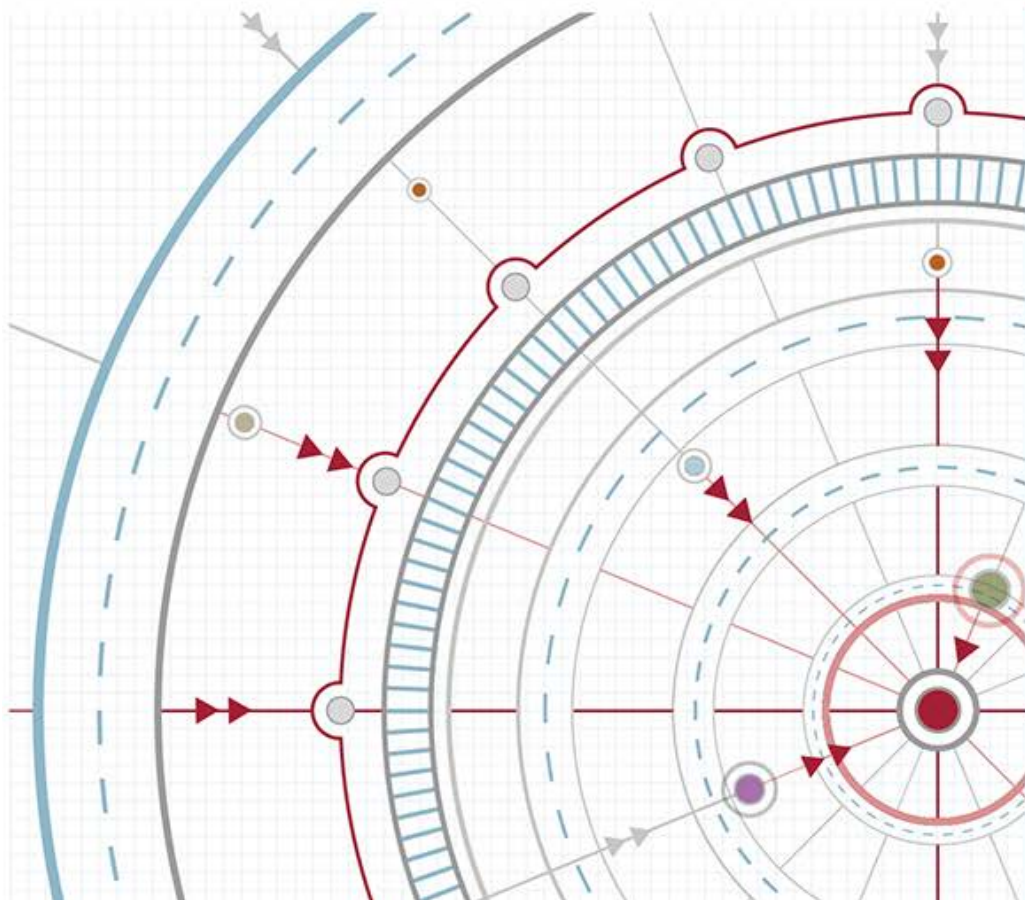
Topic	Staff condensed summary of Board’s tentative decisions
<b>Statement(s) of financial performance—other comprehensive income (OCI)</b>	<p>The Board tentatively decided to rename the two categories in the OCI section of the statement(s) of financial performance as follows:</p> <ul style="list-style-type: none"> <li>a. ‘remeasurements reported outside profit or loss’ (currently ‘OCI items that will not be reclassified subsequently to profit or loss’); and</li> <li>b. ‘income and expenses to be included in profit or loss in the future’ (currently ‘OCI items that will be reclassified subsequently to profit or loss’)</li> </ul> <p>but not to introduce a new subtotal between these two categories called ‘income after remeasurements reported outside profit or loss’.</p> <p>The Board tentatively decided:</p> <ul style="list-style-type: none"> <li>a. the staff should explore whether there is demand to remove the following presentation options in <i>IAS 1 Presentation of Financial Statements</i> for OCI: <ul style="list-style-type: none"> <li>i. presenting items of OCI either net of related tax effects, or before related tax effects (paragraph 91 of IAS 1); and</li> <li>ii. presenting reclassification adjustments in the statement(s) of financial performance or in the notes (paragraph 94 of IAS 1).</li> </ul> </li> <li>b. not to develop separate guidance or educational material on the presentation of OCI for entities, but to consider both profit or loss and OCI when developing proposals for better aggregation/disaggregation and additional minimum line items.</li> <li>c. not to develop educational material for investors in the form of case studies that illustrate why it is important for users of financial statements to consider items of OCI in their analysis of companies.</li> </ul>
<b>Management performance measure(s)</b>	<p>The Board tentatively decided:</p> <ul style="list-style-type: none"> <li>a. all entities shall identify a measure (or measures) of profit or comprehensive income that, in the view of management, communicates to users the financial performance of the entity. This measure will: <ul style="list-style-type: none"> <li>i. often only be a subtotal or total specified by paragraph 81A of IAS 1.</li> <li>ii. sometimes be identified by management as a measure that is not a subtotal or total specified by paragraph 81A of IAS 1, but would complement those subtotals or totals. Such a measure is a management performance measure.</li> </ul> </li> <li>b. the following requirements apply to management performance measures described in paragraph a(ii): <ul style="list-style-type: none"> <li>i. a reconciliation would be provided in the notes between that measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1;</li> <li>ii. that there should be no specific constraints on management performance measures;</li> <li>iii. the measure would be labelled in a clear and understandable way so as not to mislead users; and</li> <li>iv. the following information is required to be disclosed: <ol style="list-style-type: none"> <li>1. a statement that the measure provides management’s view of the entity’s financial performance and is not necessarily comparable with measures provided by other entities;</li> <li>2. a description of why the management performance measure provides management’s view of performance, including an explanation of <ul style="list-style-type: none"> <li>• how the management performance measure has been calculated and why; and</li> <li>• how the measure provides useful information about an entity’s financial performance</li> </ul> </li> <li>3. sufficient explanation, if there is a change in how the management performance measure is calculated during the year, to help users understand the reasons for and effect of the change.</li> </ol> </li> </ul> </li> </ul>

Topic	Staff condensed summary of Board's tentative decisions
	<p>c. that the reconciliation between the management performance measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1 should be provided separately from the operating segment information disclosed in accordance with IFRS 8 <i>Operating Segments</i>. However, entities would not be prohibited from also including management performance measures within the operating segment information. Furthermore, the following information would be required to be disclosed:</p> <ul style="list-style-type: none"> <li>i. an explanation of how the management performance measure differs from the total of the measures of profit or loss for the reportable segments; and</li> <li>ii. if none of the management performance measures fits into the operating segment information, an explanation of why this is the case.</li> </ul> <p>For the purposes of these proposals, paragraph 81A of IAS 1 would include the existing subtotals in that paragraph and the proposed new required subtotals developed as part of this project, for example, profit before financing and income tax. The Board tentatively decided to expand the list of subtotals and totals that would not be considered management performance measures to include the following: profit before tax, profit from continuing operations, gross profit, defined as revenue less cost of sales, and operating profit before depreciation and amortisation. The Board members advised caution in drafting to clearly distinguish these subtotals from those that are specifically required to be presented by all entities in paragraph 81A of IAS 1.</p> <p>The Board also asked the staff to clarify in drafting that management performance measures provide additional information that complements the subtotals and totals specified by paragraph 81A of IAS 1, rather than provides a better view of financial performance.</p> <p>The above tentative decisions describe disclosure requirements for management performance measures in the notes only. Consequently, it does not affect the presentation of additional subtotals in the statement(s) of financial performance in accordance with paragraphs 85–85A of IAS 1.</p> <p>The Board tentatively decided to require the reconciliation described in paragraph b(i) to be disclosed in the notes rather than be provided below the statement(s) of financial performance.</p> <p>The Board tentatively decided to prohibit the use of columns to present information about management performance measures in the statement(s) of financial performance.</p>
<b>Adjusted earnings per share (EPS)</b>	<p>The Board tentatively decided that, if an entity identifies a management performance measure,</p> <ul style="list-style-type: none"> <li>a. it will be required to disclose in the notes the effect of tax and non-controlling interests separately for each of the differences between the management performance measure and the most directly comparable subtotal or total in paragraph 81A in IAS 1.</li> <li>b. it will not be required to disclose in the notes adjusted EPS calculated consistently with the management performance measure.</li> </ul> <p>The Board also tentatively decided that</p> <ul style="list-style-type: none"> <li>a. an entity would continue to be permitted to disclose adjusted EPS.</li> <li>b. an entity would be prohibited from presenting adjusted EPS in the statement(s) of financial performance.</li> </ul>
<b>Statement of cash flows—project scope</b>	<p>The Board tentatively decided to explore the following topics in this project:</p> <ul style="list-style-type: none"> <li>a. elimination of options for the classification of the cash effects of interest and dividends in the statement of cash flows;</li> <li>b. alignment of the operating section across the statement of cash flows and the statement(s) of financial performance; and</li> </ul>

Topic	Staff condensed summary of Board's tentative decisions
	<ul style="list-style-type: none"> <li>c. requiring a consistent starting point for the indirect reconciliation of cash flows.</li> </ul>
<b>Statement of cash flows—general</b>	<p>The Board tentatively decided to:</p> <ul style="list-style-type: none"> <li>a. remove from IAS 7 options for the classification of interest and dividends paid and of interest and dividends received and prescribe a single classification for each of these items.</li> <li>b. clarify that:               <ul style="list-style-type: none"> <li>i. cash flows arising from interest incurred on financing activities should be classified as financing cash flows.</li> <li>ii. cash flows arising from interest paid that is capitalised as part of the cost of an asset should be classified as financing cash flows.</li> <li>iii. cash flows arising from dividends paid should be classified as financing cash flows.</li> </ul> </li> <li>c. amend the definition of 'investing activities' in IAS 7 to clarify that interest and dividends received should be classified as investing cash flows.</li> </ul> <p>The Board tentatively decided:</p> <ul style="list-style-type: none"> <li>a. to require a consistent subtotal as the starting point for the indirect reconciliation of cash flows from operating activities.</li> <li>b. not to align the operating section of the statement of cash flows with a corresponding section in the statement(s) of financial performance.</li> <li>c. not to make other further improvements to the statement of cash flows, besides those mentioned above.</li> </ul>
<b>Statement of cash flows—associates and joint ventures</b>	<p>The Board tentatively decided to propose:</p> <ul style="list-style-type: none"> <li>a. separate presentation of (i) the investing cash flows that arise between an entity and its 'integral' associates and joint ventures and (ii) the investing cash flows that arise between an entity and its 'non-integral' associates and joint ventures. The split between 'integral' and 'non-integral' associates and joint ventures would be the same for the statement of cash flows as for the statement(s) of financial performance.</li> <li>b. the separate presentation of the investing cash flows of 'integral' and 'non-integral' associates and joint ventures should be within the 'investing activities' section of the statement of cash flows.</li> </ul>
<b>Other topics—project scope</b>	<p>The Board tentatively decided to explore the following topics:</p> <ul style="list-style-type: none"> <li>a. development of templates for the statement(s) of financial performance, the statement of cash flows and the statement of financial position for a small number of industries.</li> <li>b. development of a principle for aggregating and disaggregating items in the primary financial statements.</li> </ul> <p>The Board tentatively decided not to consider targeted improvements to the statement of financial position unless work on other areas of the primary financial statements identifies possible improvements to that statement.</p> <p>Additionally, the Board tentatively decided that segment reporting and the presentation of discontinued operations should not be part of the scope of the project.</p>
<b>Templates or examples</b>	<p>The Board tentatively decided:</p> <ul style="list-style-type: none"> <li>a. to develop non-mandatory examples to illustrate the Board's decisions regarding this project.</li> <li>b. to develop illustrative examples of:</li> </ul>

Topic	Staff condensed summary of Board's tentative decisions
	<ul style="list-style-type: none"> <li>i. the statement(s) of financial performance for different types of entities;</li> <li>ii. the statement of cash flows for a financial entity and a non-financial entity based on the current illustrative examples in IAS 1; and</li> <li>iii. any notes that are introduced or amended by the project.</li> </ul> <p>c. to include illustrative examples for the statement(s) of financial performance for the following types of entity:</p> <ul style="list-style-type: none"> <li>i. a non-financial entity (both by function and by nature);</li> <li>ii. an investment property company;</li> <li>iii. an insurer;</li> <li>iv. a traditional bank with no material investing activities;</li> <li>v. a bank engaged in both investing and customer financing activities;</li> <li>vi. a bank-insurer;</li> <li>vii. a manufacturer that conducts investing activities; and</li> <li>viii. a manufacturer that provides financing to customers.</li> </ul> <p>The Board noted that this list of entity types may need to be revised following further discussion of the application of the Board's tentative decisions to financial entities.</p>
<b>Principles of aggregation and disaggregation</b>	<p>The Board tentatively decided to develop:</p> <ul style="list-style-type: none"> <li>a. principles for aggregation and disaggregation in the financial statements;</li> <li>b. definitions of the notions 'classification', 'aggregation' and 'disaggregation'; and</li> <li>c. guidance on the steps involved in applying 'classification', 'aggregation' and 'disaggregation' when preparing financial statements.</li> <li>d. guidance on disaggregation by nature and by function in the statement of financial performance</li> </ul> <p>The Board tentatively decided to include a principle for determining the location of financial information in the primary financial statements or the notes that is based on the role of the primary financial statements and the role of the notes suggested in Discussion Paper Disclosure Initiative—Principles of Disclosure. That principle would not override the specific requirements of IAS 1 for the presentation of minimum line items and subtotals in the primary financial statements. An entity should also apply that principle when a Standard allows entities to determine whether to provide financial information in the primary financial statements or in the notes.</p> <p>The Board discussed whether to introduce numerical thresholds or rebuttable presumptions for aggregating or disaggregating financial information but decided not to introduce such thresholds. Instead, the Board decided to explore whether principle-based guidance could be developed to encourage further disaggregation of large residual balances or 'other' balances.</p> <p>The Board will explore further ways to improve disaggregation in the financial statements, which may include illustrating how different characteristics could be used to aggregate or disaggregate financial information. The Board clarified that any further guidance developed in this respect would not override specific aggregation or disaggregation requirements in individual IFRS Standards.</p> <p>The Board tentatively decided to:</p> <ul style="list-style-type: none"> <li>a. describe the 'nature of expense' method and the 'function of expense' method used to analyse expenses required by paragraph 99 of IAS 1.</li> </ul>

Topic	Staff condensed summary of Board's tentative decisions
	<ul style="list-style-type: none"> <li>b. continue to require an entity to provide an analysis of expenses using the methodology, either by-function or by-nature, that provides the most useful information to users.</li> <li>c. describe factors that entities would consider to determine whether a by-function or by-nature methodology provides the most useful information to users. These are:               <ul style="list-style-type: none"> <li>i. which method provides the best information about the key components or drivers of profitability;</li> <li>ii. which method most closely matches how management reports internally to the board or key decision makers and the way the business is run;</li> <li>iii. peer industry practice; and</li> <li>iv. whether the allocation of expenses to functions would be so arbitrary that it would not provide a sufficiently faithful representation of the composition of an entity's functions. In such cases, a 'by nature' method should be used.</li> </ul> </li> <li>d. provide no requirement for entities that use the 'nature of expense' method to provide additional information using the 'function of expense' method.</li> <li>e. require an entity to:               <ul style="list-style-type: none"> <li>i. present its primary analysis of expenses in the statement(s) of financial performance; and</li> <li>ii. when an entity provides primary analysis of expenses using a by-function methodology, require the entity to disclose in a single note additional information on the nature of the expense. This information would be provided at an entity level, not as a breakdown of each functional line presented.</li> </ul> </li> </ul>
<b>Disaggregation—separate disclosure of unusual or infrequent items</b>	<p>The Board tentatively decided to:</p> <ul style="list-style-type: none"> <li>a. require separate disclosure of information about unusual or infrequent items regardless of whether an entity chooses to disclose a management performance measure.</li> <li>b. require separate disclosure of unusual or infrequent items in the notes to the financial statements and require that those items be attributed to line items in the statement(s) of financial performance.</li> <li>c. develop principle-based guidance to help entities identify unusual or infrequent items.</li> </ul>
<b>Minimum line items</b>	<p>The Board tentatively decided:</p> <ul style="list-style-type: none"> <li>a. to clarify that the line items that are required to be presented in the statement(s) of financial performance may need to be presented in more than one section of that statement;</li> <li>b. to remove the requirement in paragraph 82(b) of IAS 1 to present 'finance costs' in the statement(s) of financial performance; and</li> <li>c. to clarify that when line items are required to be presented in the statement(s) of financial performance, that requirement necessitates separate presentation, regardless of the method of analysis of expenses within operating profit.</li> </ul>



# IFRS for SMEs® Standard

## Background to the IFRS for SMEs Standard

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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in the IASB® *Update*.

- Development of the *IFRS for SMEs* Standard
- Why the Board developed the *IFRS for SMEs* Standard
- Scope of the *IFRS for SMEs* Standard
- Maintenance of the *IFRS for SMEs* Standard
- Supporting the *IFRS for SMEs* Standard
- Global adoption of the *IFRS for SMEs* Standard

# Development of the *IFRS for SMEs* Standard

# Development of the *IFRS for SMEs* Standard

2000

- International Accounting Standards Committee observed that a demand for special version of accounting standards for small enterprises

2001

- International Accounting Standards Board (Board) commences a project to develop an accounting standard for Small and Medium-sized Entities (SMEs)

2002

- Standards Advisory Council (predecessor to the IFRS Advisory Council) supports project to create an SMEs standard

# Development of the *IFRS for SMEs* Standard

June  
2004

- The Board publishes Discussion Paper *Preliminary views on accounting standards for SMEs*
  - invites comments on Board's approach to project
  - receives 120 comment letters

Discussion  
Paper  
Feedback

- Stakeholders support development of the *IFRS for SMEs* Standard
- The stakeholders prefer adopting the *IFRS for SMEs* Standard as developed by Board rather than locally or regionally developed standards

February  
2007

- Board published Exposure Draft examining a proposed stand-alone standard for small and medium-sized entities
- receives 162 comment letters

# Development of the *IFRS for SMEs* Standard

March  
2008

- Board begins deliberations of feedback on the Exposure Draft

July 2009

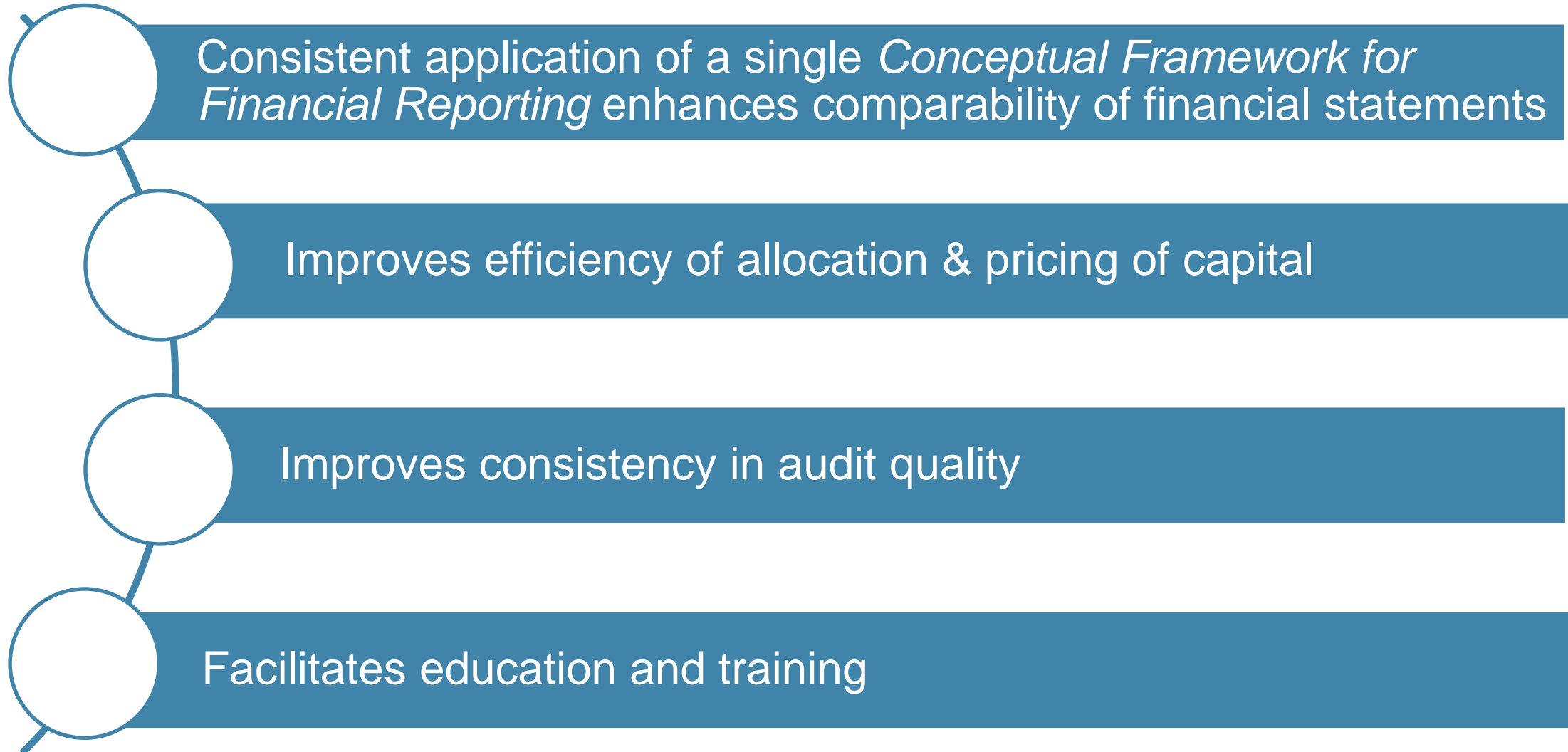
- Board issues the *IFRS for SMEs* Standard

2010

- The SME Implementation Group (SMEIG) established

# Why the Board developed the *IFRS for SMEs* Standard

# Why a global standard for Small and Medium Entities (SMEs)?



# Considerations in developing an *IFRS for SMEs* Standard?

Is developing an *IFRS for SMEs* Standard consistent with Board's mission?

- The IFRS Foundation *Constitution*<sup>1</sup> states that fulfilling objectives takes into account, as appropriate, the needs of a range of entity sizes and types in diverse economic settings

Should Standards for SMEs be developed by others?

- The Board considered whether an SMEs standard should be developed country-by-country, at a regional level, or by the Board
- The Board decided that by developing an SMEs standard itself, it would bring global consistency & comparability to financial statements

Do national standard-setters support the Board developing an *IFRS for SMEs* Standard?

- National standard-setters support the Board developing a standard for SMEs

<sup>1</sup> IFRS *Constitution* para 2(c), as at 29 November 2018.

# Scope of the *IFRS for SMEs* Standard

- The *IFRS for SMEs* Standard is intended for non-publicly accountable entities that publish general purpose financial statements for external users
- Main users of the financial statements are:
  - banks
  - shareholders that are not managers
  - customers of SMEs
  - vendors that sell to SMEs in making pricing and credit decisions
  - credit-rating agencies that use financial statements to rate SMEs

In defining the scope for the *IFRS for SMEs* Standard the Board considered the application of the Standard to various entities, including:

- those whose securities are traded in public markets;
- financial institutions that have public accountability;
- SMEs providing essential public services; and
- SMEs that are economically significant in home jurisdictions.

- The *IFRS for SMEs* Standard describes small and medium-sized entities as those that:
  - do not have public accountability; and
  - publish general purpose financial statements for external users

An entity's debt  
or equity  
instruments are  
traded on a  
public market

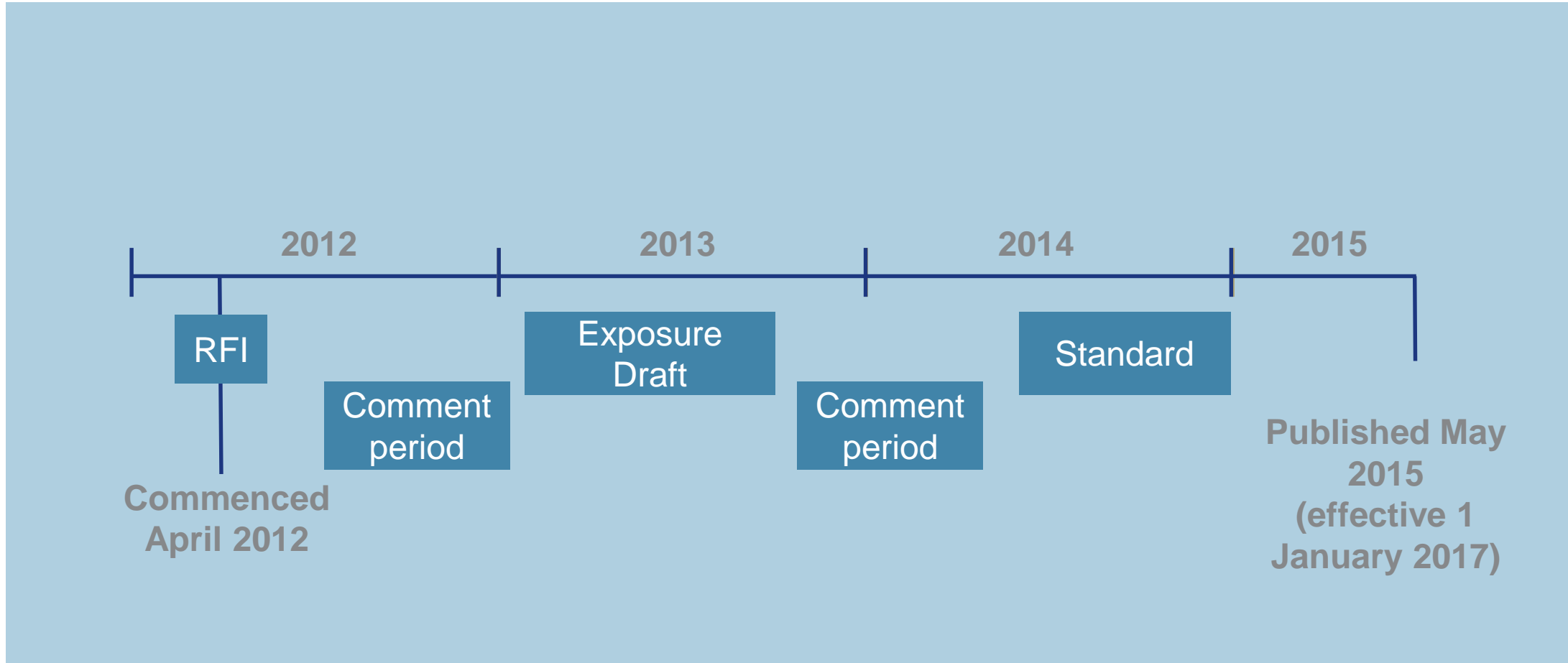
OR

An entity holds  
assets in a  
fiduciary capacity  
for a broad group  
of outsiders as  
one of its primary  
businesses

# Maintenance of the *IFRS for SMEs* Standard

# Initial comprehensive review of the *IFRS for SMEs* Standard

- Timeline:



# Scope of the initial Request for Information

Use by publicly traded entities

- Should some publicly traded entities be permitted to apply the *IFRS for SMEs* Standard?

Use by financial institutions & similar entities

- Should some financial institutions be permitted to apply *IFRS for SMEs* Standard?

Clarification of use by not-for-profit entities

- Should the *IFRS for SMEs* Standard be revised to clarify if not-for-profit entities are eligible to apply it?

# Scope of the initial Request for Information

Consider new & revised Standards

- Should *IFRS for SMEs* Standard be amended to reflect new and amendments to IFRS Standards?

Implementation challenges identified by entities applying *IFRS for SMEs* Standard

- Are there implementation challenges of applying *IFRS for SMEs* Standard?
- Should income tax recognition and measurement requirements be aligned to IAS 12?

- The Board received feedback on all questions in the Request for Information
- The Board decided, because the *IFRS for SMEs* Standard was still newly adopted in many jurisdiction, to focus on:
  - maintaining stability;
  - amending for implementation challenges only; and
  - supporting current practice.
- The Board decided that a subsequent review would be more comprehensive and revisit matters from the 2012 Review

## Key amendments:

- permitted **revaluation model** for property, plant and equipment
- aligned recognition and measurement requirements for **income tax** with IFRS Standards; and
- included further targeted **undue cost or effort exemptions**, plus
  - guidance on **application** of the exemption; and
  - required **disclosure** of reasoning.

## Most other amendments:

- clarified or added guidance; and
- applied to ‘non-typical’ SME transactions.

# Recommendations for future review of the *IFRS for SMEs* Standard

- The Board recommended that for future reviews:
  - Each new and revised IFRS Standard was **considered individually**
  - Considered only once published
  - Assessed based on implementation experience
- Possible modifications would be based on **users' needs and cost-benefit** considerations



# Supporting the *IFRS for SMEs* Standard

- The SME Implementation Group (SMEIG) was formed to support implementation of the *IFRS for SMEs* Standard.
- The SMEIG terms of reference are to:
  - consider & make recommendations to Board on need to amend the *IFRS for SMEs* Standard; and
  - consider implementation questions raised by users of the *IFRS for SMEs* Standard.
- The group has 28 member accountants from countries from around the world.

- Implementation questions can be submitted at any time:
  - referred to SME Implementation Group (SMEIG) if likely to meet criteria in paragraph 15 of SMEIG Terms of Reference and Operating Procedures; or
  - considered when updating education materials.
- The questions are used to develop non-mandatory guidance about implementing the *IFRS for SMEs* Standard.

# Supporting *IFRS for SMEs* Standard—modules

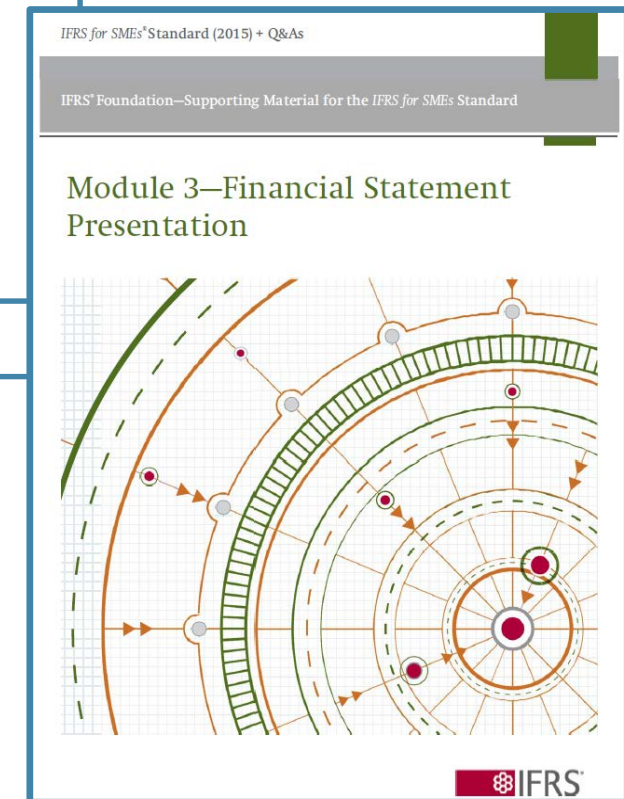
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## Purpose

- designed to support anyone learning about, applying, or reading financial statements prepared using the *IFRS for SMEs* Standard

## A module for each section of the Standard includes

- the section's requirements;
- significant estimates and other judgements;
- comparison with full IFRS Standards; and
- comprehensive examples and activities.

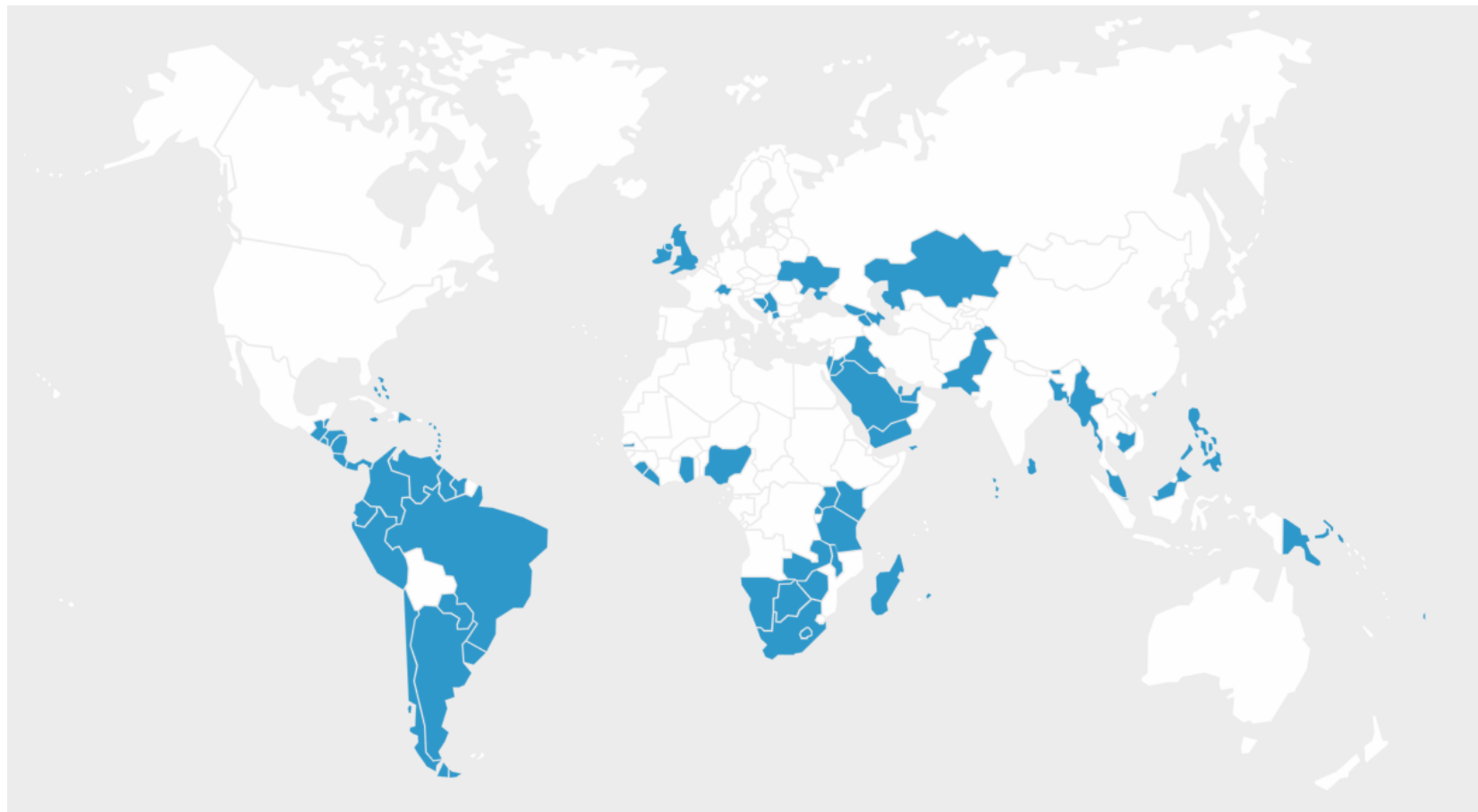


# Supporting *IFRS for SMEs* Standard— stakeholder engagement


- As part of outreach initiatives, the Board has discussed the *IFRS for SMEs* Standard following groups:
  - World Standard-setters;
  - Emerging Economies Group; and
  - Asian-Oceanian Standard-Setters Group (AOSSG).
- Questions from the groups focused on:
  - issues for the Board to consider in the next review;
  - the scope of the Request for Information; and
  - feedback from an AOSSG survey.

# Global adoption of the *IFRS for SMEs* Standard

# Adoption of the *IFRS for SMEs* Standard



**86 of 166**  
jurisdictions  
require or  
permit use of  
the *IFRS for*  
*SMEs* Standard

 = the *IFRS for SMEs*  
Standard is required or  
permitted

- Good financial reporting made simple:
  - less than 250 pages;
  - **simplified IFRS Standard** built on a foundation of IFRS Standards;
  - **stand-alone**;
  - designed **specifically for SMEs**; and
  - internationally recognised.

# Get involved

Find out more: [www.ifrs.org](http://www.ifrs.org)

- Follow us:
-  @IFRSFoundation
  -  IFRS Foundation  
International Accounting Standards Board
  -  IFRS Foundation
  -  IFRS Foundation

Join our team: [go.ifrs.org/careers](http://go.ifrs.org/careers)



# STAFF PAPER

February 2019

## IASB® meeting

Project	IFRS for SMEs Standard	
Paper topic	Project plan for the comprehensive review of the <i>IFRS for SMEs</i> ® Standard	
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in the IASB® *Update*.

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## Purpose of this paper

1. At this meeting we are seeking Board members views on:
  - (a) the proposed project timetable for the 2019 Review of the *IFRS for SMEs* Standard (2019 Review);
  - (b) the focus of the Request for Information; and
  - (c) proposed topics for the Board to discuss in developing the Request for Information.
  
2. A presentation on the background to the *IFRS for SMEs* Standard is set out at Agenda Paper 30A. The background will not be presented at the Board meeting, however Board members will have an opportunity to ask questions.

### Structure of the paper

3. This paper is set out as follows:
  - (a) background to the 2019 Review—paragraphs 5–8;
  - (b) proposed project timetable—paragraph 9;
  - (c) focus of a Request for Information—paragraphs 10–15; and
  - (d) topics for the Board to discuss in developing the Request for Information—paragraphs 16–17.
4. We also include two appendices:
  - (a) Appendix 1—Timeline for the 2019 Review of the *IFRS for SMEs* Standard; and
  - (b) Appendix 2—New and revised IFRS Standards since the first comprehensive review of the IFRS for SMEs Standard.

### Background to the 2019 Review

5. In accordance with paragraph P16 of the *IFRS for SMEs* Standard, the Board is committed to reviewing the *IFRS for SMEs* Standard not more frequently than once every three years.
6. The first comprehensive review of the *IFRS for SMEs* Standard commenced in 2012 (2012 Review), culminating in the publication of the *2015 Amendments to the IFRS for SMEs* which became effective 1 January 2017.
7. As part of the 2012 Review, the Board decided subsequent reviews of the *IFRS for SMEs* Standard should commence two years after the effective date of the amendments from the previous review (*IFRS for SMEs Basis for Conclusions* Paragraph BC264(a))—in this instance, after 1 January 2019.

8. We are proposing the 2019 Review has 3 phases:
- (a) Phase 1– developing and issuing a Request for Information
  - (b) Phase 2 – analysing feedback and issuing an Exposure Draft; and
  - (c) Phase 3 – analysing of feedback from the Exposure Draft and issuing amendments to the *IFRS for SMEs* Standard.

**Proposed project timetable**

9. The following table sets out a proposed timetable, further information is set out in Appendix 1 of this paper.

**Table 1: Proposed timetable for the 2019 Review**

Year	Month	Activity
2019	<b>Phase 1</b>	
	February–May	<b>Board discussions</b> • developing Request for Information.
	July	<b>Request for Information issued</b>
	November	<b>Request for Information comment deadline</b>
2020	<b>Phase 2</b>	
	January – December	<b>Board discussions</b> • feedback on the Request for Information; • decision to proceed; • developing Exposure Draft; and • balloting.
2021	January	<b>Board discussions</b> • balloting
	February	<b>Exposure Draft issued</b>
	June	<b>Exposure Draft comment deadline</b>
	<b>Phase 3</b>	
	July – December	<b>Board discussions</b> • feedback on the Exposure Draft; • decision to proceed; and • developing amendments to <i>IFRS for SMEs</i> Standard
2022	January – February	<b>Board discussions</b> • balloting
	May	<b>IFRS for SMEs Standard—2022 version issued</b>

## Focus of the Request for Information

10. The objective of the Request for Information is to provide the Board with evidence to enable it to decide if, and how, to develop an Exposure Draft of amendments to the *IFRS for SMEs* Standard.
11. As part of the 2019 Review, the Board will need to consider whether the *IFRS for SMEs* Standard should be updated for IFRS Standards and amendments not currently incorporated in the *IFRS for SMEs* Standard. These include:
  - (a) IFRS Standards and amendments issued after commencement of the 2012 Review (see Appendix 2 of this paper).
  - (b) IFRS Standards and amendments issued before commencement of the 2012 Review but not yet incorporated into the *IFRS for SMEs* Standard, including IFRS 3 *Business Combinations*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*.
12. Consequently, the Board has a significant number of IFRS Standards and amendments to consider incorporating into the *IFRS for SMEs* Standard as part of the 2019 Review. In view of this we propose that the 2019 Request for Information be strategically focused on obtaining views on whether and how to incorporate IFRS Standards and amendments into the *IFRS for SMEs* Standard.
13. Developing a strategically focused Request for Information should provide the Board with feedback on which to make informed decisions in developing a possible Exposure Draft for amendments to the *IFRS for SMEs* Standard.
14. We believe that a strategically focused Request for Information will be effective in managing the Board's time. That focus will allow the Board to seek views on the incorporation of IFRS Standards and amendments before investing time and resources on drafting proposed amendments to the *IFRS for SMEs* Standard that may not proceed to an Exposure Draft.

15. The SME Implementation Group (SMEIG) played a significant role in the 2012 Review, and we would expect the same in the 2019 Review. We will provide the SMEIG with copies of Board papers and request feedback to assist the Board in developing the Request for Information.

### **Topics for the Board to discuss in developing the Request for Information**

16. The objective of discussions with the Board in the first half of 2019 is to define the questions that will be asked in the Request for Information.
17. The staff expect to bring the following papers to the Board:

#### **March 2019**

- (a) the scope of the *IFRS for SMEs* Standard—should the Board amend the scope of the *IFRS for SMEs* Standard?
- (b) the relationship between the *IFRS for SMEs* Standard and IFRS Standards—what should be the key principles in deciding whether to, and if so how to, incorporate IFRS Standards into the *IFRS for SMEs* Standard?

#### **April 2019**

- (c) IFRS Standards—should the Board update the *IFRS for SMEs* Standard for IFRS Standards not currently incorporated (including IFRS 9—IFRS 16)?
- (d) amendments to IFRS Standards— should the Board update the *IFRS for SMEs* Standard for amendments to IFRS Standards not currently incorporated (including changes to the definition of a business and the definition of materiality)?

**May 2019**

- (e) other matters related to the *IFRS for SMEs* Standard:
- i. review of differences between IFRS Standards and the *IFRS for SMEs* Standard, for example, differences in the capitalisation of development costs.
  - ii. specific SME matters not covered by IFRS Standards, for example, crowd funding or cryptocurrencies.

**Questions for the Board****Questions for the Board**

1. Does the Board agree with the project timeline proposed in Table 1? [Paragraph 9]
2. Does the Board agree that the Request for Information should be strategically focused on obtaining views on if, and how, to incorporate IFRS Standards into the *IFRS for SMEs* Standard? [Paragraph 12]
3. Does the Board agree with the proposed topics to be discussed at future Board meetings? [Paragraph 17]

### Appendix 1—Timeline for the 2019 Review of the *IFRS for SMEs* Standard

Year	Month	Activity
2019	<b>Phase 1</b>	
	February	<b>Board discussions</b> <ul style="list-style-type: none"> <li>• developing the Request for Information.</li> </ul> <b>Research</b> <ul style="list-style-type: none"> <li>• compiling academic relevant academic research.</li> </ul>
	March	<b>Board discussions</b> <ul style="list-style-type: none"> <li>• the scope of the <i>IFRS for SMEs</i> Standard; and</li> <li>• the relationship between the <i>IFRS for SMEs</i> Standard and IFRS Standards.</li> </ul> <b>Outreach</b> <ul style="list-style-type: none"> <li>• Advisory Council—public accountability; and</li> <li>• International Forum of Accounting Standard Setters—public accountability.</li> </ul>
	April	<b>Board discussions</b> <ul style="list-style-type: none"> <li>• new IFRS Standards; and</li> <li>• amendments to IFRS Standards.</li> </ul>
	May	<b>Board discussions</b> <ul style="list-style-type: none"> <li>• other matters related to the <i>IFRS for SMEs</i> Standard; and</li> <li>• specific SME matters not covered by IFRS Standards.</li> </ul>
	July	<b>Board discussions</b> <ul style="list-style-type: none"> <li>• Request for Information approval</li> </ul> <b>Request for Information issued</b>
	Aug.–October	<b>Outreach</b> <ul style="list-style-type: none"> <li>• including World Standard-setters and Emerging Economies Group;</li> <li>• raising awareness about Request for Information; and</li> <li>• gathering feedback.</li> </ul>
	November	<b>Request for Information comment deadline</b>

Year	Month	Activity
2020	<b>Phase 2</b>	
	January	<b>Board discussions</b> • feedback on the Request for Information.
	February	<b>SMEIG meeting</b> • face-to-face meeting to discuss feedback.
	Mar. - November	<b>Board discussions</b> • decision to proceed; • developing Exposure Draft; and • balloting. <b>Outreach</b> • Advisory Council—project update.
	December	<b>Balloting</b>
2021	January	<b>Balloting</b>
	February	<b>Exposure Draft issued</b>
	Mar. - May	<b>Outreach</b> • raising awareness about Exposure Draft; and • gathering feedback.
	June	<b>Exposure Draft comment deadline</b>
	<b>Phase 3</b>	
	July	<b>Board discussions</b> • feedback on the Exposure Draft.
	Sept – December	<b>Board discussions</b> • developing amendments to <i>IFRS for SMEs</i> Standard.
2022	January – February	<b>Board discussions</b> • balloting.
	May	<b><i>IFRS for SMEs</i> Standard—2022 version issued</b>

**Appendix 2—New and revised IFRS Standards since the first comprehensive review of the IFRS for SMEs Standard**

SME section	IFRS Standard or Amendments	Issue date
No Equivalent Section	<i>Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts</i>	20 May 2013
	<i>IFRS 14 Regulatory Deferral Accounts</i>	30 January 2014
Section 2 <i>Concepts and Pervasive Principles</i>	<i>Conceptual Framework for Financial Reporting</i>	01 March 2018
Section 3 <i>Financial Statement Presentation</i>	<i>Definition of Material</i>	01 October 2018
	<i>Disclosure Initiative</i>	18 December 2014
Section 7 <i>Statement of Cash Flows</i>	<i>Disclosure Initiative</i>	29 January 2016
Section 9 <i>Consolidated and Separate Financial Statements</i>	<i>Equity Method in Separate Financial Statements</i>	12 August 2014
	<i>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture</i>	11 September 2014
Section 10 <i>Accounting Policies, Estimates and Errors</i>	<i>Definition of Material</i>	01 October 2018
Section 11 <i>Basic Financial Instruments</i>	<i>Annual Improvements to IFRSs 2011–2013 Cycle (fair value measurement - IFRS 13)</i>	12 December 2013
	<i>IFRS 9 Financial Instruments</i>	29 July 2014
	<i>Prepayment Features with Negative Compensation</i>	01 October 2017
&	<i>IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)</i>	20 November 2013
Section 12 <i>Other Financial Instrument Issues</i>	<i>Novation of Derivatives and Continuation of Hedge Accounting</i>	27 June 2013
	<i>Prepayment Features with Negative Compensation</i>	01 October 2017

SME section	IFRS Standard or Amendments	Issue date
Section 14 <i>Investments in Associates</i>	<i>Long-term Interests in Associates and Joint Ventures</i>	01 October 2017
	<i>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture</i>	11 September 2014
Section 15 <i>Investments in Joint Ventures</i>	<i>Accounting for Acquisitions of Interests in Joint Operations</i>	06 May 2014
	<i>Annual Improvements to IFRS Standards 2015–2017 Cycle</i>	01 December 2017
Section 16 <i>Investment Property</i>	<i>Annual Improvements to IFRS Standards 2011–2013 Cycle</i>	12 December 2013
	<i>Transfers of Investment Property</i>	08 December 2016
Section 17 <i>Property, plant and Equipment</i>	<i>Annual Improvements to IFRS Standards 2010-2012 Cycle</i>	11 December 2013
	<i>Clarification of Acceptable Methods of Depreciation and Amortisation</i>	12 May 2014
Section 18 <i>Intangible Assets other than Goodwill</i>	<i>Annual Improvements to IFRS Standards 2010-2012 Cycle</i>	11 December 2013
	<i>Clarification of Acceptable Methods of Depreciation and Amortisation</i>	12 May 2014
Section 19 <i>Business Combinations and Goodwill</i>	<i>Annual Improvements to IFRS Standards 2015–2017 Cycle</i>	01 December 2017
	<i>Annual Improvements to IFRS Standards 2010 - 2012 Cycle</i>	11 December 2013
	<i>Annual Improvements to IFRS Standards 2011–2013 Cycle</i>	12 December 2013
	<i>Definition of Business</i>	01 October 2018
Section 20 <i>Leases</i>	IFRS 16 <i>Leases</i>	13 January 2016
Section 21 <i>Provisions and Contingencies</i>	IFRIC 21 <i>Levies</i>	20 May 2013
Section 23 <i>Revenue</i>	<i>Clarifications to IFRS 15 Revenue from Contracts with Customers</i>	11 April 2016
	IFRS 15 <i>Revenue from Contracts with Customers</i>	28 May 2014
Section 25 <i>Borrowing Costs</i>	<i>Annual Improvements to IFRS Standards 2015–2017 Cycle</i>	01 December 2017

SME section	IFRS Standard or Amendments	Issue date
Section 26 <i>Share-Based Payment</i>	<i>Annual Improvements to IFRS Standards 2010–2012 Cycle</i>	11 December 2013
	<i>Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)</i>	21 June 2016
	<i>Group Cash-settled Share-based Payment Transactions (IFRS 2 amendments)</i>	18 June 2009
Section 27 <i>Impairment of Assets</i>	<i>Recoverable Amount Disclosures for Non-Financial Assets</i>	29 May 2013
Section 28 <i>Employee Benefits</i>	<i>Defined Benefit Plans: Employee Contributions</i>	21 November 2013
	<i>Plan Amendment, Curtailment or Settlement</i>	01 February 2018
	<i>Annual Improvements to IFRS Standard 2012–2014 Cycle</i>	25 September 2014
Section 29 <i>Income Tax</i>	<i>Annual Improvements to IFRS Standards 2015–2017 Cycle</i>	01 December 2017
	<i>IFRIC 23: Uncertainty over Income Tax Treatments</i>	01 June 2017
	<i>Recognition of Deferred Tax Assets for Unrealised Losses</i>	19 January 2016
Section 30 <i>Foreign Currency Translation</i>	<i>IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration</i>	08 December 2016
Section 33 <i>Related Party Disclosures</i>	<i>Annual Improvements to IFRS Standards 2010–2012 Cycle</i>	11 December 2013
Section 34 <i>Specialised Activities</i>	<i>Agriculture: Bearer Plants</i>	30 June 2014
Section 35 <i>Transition to the IFRS for SMEs Standard</i>	<i>Annual Improvements to IFRS Standards 2011–2013 Cycle</i>	12 December 2013