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Solutions to IFRS 9 and IFRS 4 Phase II decoupling

The IASB completes its work and targets publication in September 2016

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Agenda

- **Highlights of the IASB meeting held on 17 May 2016**
- **IASB Staff analysis, recommendations, IASB discussion and tentative decisions**
- **Next steps**

Highlights of the IASB meeting on 17 May 2016

- Deferral approach
  - Mandatory reassessment of eligibility
  - Sunset clause on 1 January 2021
  - Voluntary termination of deferral approach from the start of any subsequent year
- Overlay approach
  - No fixed expiry date
- Allow non-uniform accounting under equity accounting method
- Overlay approach and deferral approach will be available to first time adopters
- Balloting process approved, target publication is September 2016

Reassessment of eligibility for the temporary exemption from applying IFRS 9

Staff Analysis – Mandatory reassessment of eligibility

- An entity should no longer be eligible for the temporary exemption if its activities are no longer predominantly related to insurance (e.g. if it acquires a bank)
- An entity would not be required to perform a reassessment if there is merely a change in the level of insurance activities relative to total liabilities
- Expect a demonstrable change in the corporate structure will occur infrequently
- Special disclosures required when reassessment leads to the end of deferral approach

Reassessment of eligibility for the temporary exemption from applying IFRS 9

Staff Analysis – Optional reassessment before mandatory effective date

- An entity that has a change in corporate structure such that its activities become predominantly related to insurance should be permitted to apply the temporary exemption, as long as it has not previously applied any version of IFRS 9 (except ‘own credit’ requirements in isolation)
- There is not a compelling reason to have a different ‘trigger’ from a change in predominant activities
- When an entity becomes eligible after the 1/4/15-31/3/16 test period, it is important that the reasons for that change are transparent

Reassessment of eligibility for the temporary exemption from applying IFRS 9

Staff recommendations

- **Required to reassess** whether the activities are still predominantly related to insurance if there has been a **demonstrable change in the corporate structure** that could result in a change in the predominant activities
- An entity that is required to reassess its eligibility should **compute the predominance ratio** using the carrying amounts of the liabilities at the **end of the annual reporting period immediately following the change in corporate structure**
- If an entity concludes that its activities are no longer predominantly related to insurance, it is required:
  - to apply IFRS 9 from **the earlier of** (1) its **second annual reporting period that begins after the change in corporate structure**, and (2) its annual reporting period that begins on **or after the fixed expiry date** of the temporary exemption, and
  - to **disclose** in the annual reporting period in which it reached that conclusion and in the subsequent annual reporting periods before it applies IFRS 9 (1) the fact that it is no longer eligible to apply the temporary exemption (2) the reason why it is no longer eligible, and (3) the date on which the change in its corporate structure occurred that made it ineligible.

Reassessment of eligibility for the temporary exemption from applying IFRS 9

Staff recommendations (continued)

- An entity that previously was not eligible should be ***permitted*** **to reassess its eligibility** if there has been a **demonstrable change in its corporate structure before the mandatory effective date of IFRS 9** that could result in a change in its predominant activities
- An entity that is permitted to reassess its eligibility should **compute the predominance ratio** using the carrying amounts of the **liabilities reported at the end of the annual reporting period immediately following** the change in corporate structure
- An entity that becomes eligible for the temporary exemption should **disclose** (1) the reason for the reassessment, (2) an explanation of the change in predominant activities, and (3) the date on which the change in corporate structure occurred that made it eligible
- A demonstrable change in corporate structure **must be significant** to the entity's operations and **demonstrable to external parties**.

Reassessment of eligibility for the temporary exemption from applying IFRS 9

IASB discussion and tentative decisions

- A Board member sought clarification about how broadly a ‘change in corporate structure’ should be interpreted.
- The Staff stated that this should be considered when there was a significant change in the business, such as acquiring a bank or disposing of an insurer, and that it was not the intention that a reporting entity should drift in and out of eligibility
- A Board member questioned whether the existence of a definitive agreement to e.g. sell an insurance subsidiary at the reassessment date but before the mandatory effective date, but where the deal had not closed, should be taken into account.
- The Staff confirmed that a commitment to sell was not sufficient, and that a sale must have taken place at the reassessment date.

Tentative decisions: unanimous approval of all recommendations

Fixed expiry date and transition to IFRS 9

Staff Analysis

- The temporary exemption would expire before the effective date of the forthcoming insurance contracts Standard only if the effective date of that Standard is for reporting periods beginning on or after 1 January 2022

- The overlay approach provides additional information about the effects of moving from IAS 39 to IFRS 9, consequently the Staff do not think there is any compelling reason to prohibit an entity from applying the overlay approach

- The temporary exemption results in the improved IFRS 9 information not being provided, thus can only be accepted for a short period. The reasons for setting a fixed expiry date for temporary exemption do not apply to the overlay approach

Fixed expiry date and transition to IFRS 9

Staff Recommendations

Confirm the following ED proposals:

- Required to cease applying the temporary exemption no late than for annual reporting periods beginning on or after **1 January 2021**
- An entity that previously elected to apply the temporary exemption **may at the beginning of any subsequent accounting period choose to apply IFRS 9**
- An entity that chooses or is required to cease applying the temporary exemption should, on initial application of IFRS 9, **use the relevant transition requirements of that IFRS**. Such entities should be **permitted**, but not required, **to apply the overlay approach** to qualifying financial assets
- The **overlay approach** should have **no fixed expiry date**
- The **temporary exemption** should be **effective** for reporting periods beginning on or after **1 January 2018**
- The **overlay approach** should be **effective when an entity first applies IFRS 9** (other than for ‘own credit’ requirements in isolation).

Fixed expiry date and transition to IFRS 9

IASB discussion and tentative decisions

- A Board member questioned whether it made sense to continue to apply the overlay approach if there was an unexpected delay in issuing the new insurance contracts Standard
- Other Board members expressed the view that this would be appropriate in those circumstances

Tentative decisions

- The Board unanimously approved all of the the Staff recommendations, other than the recommendation that there should not be a fixed expiry date for the overlay approach, where one Board member voted against this recommendation

Relief for investors in associates and joint ventures

Staff Analysis

- IAS 8 confirms that the use of uniform accounting policies extends to the financial statements of an investee used when the investor applies the equity method
- There are significant practical difficulties and/or additional costs that may arise for the investor in obtaining the relevant information
- In particular, the Staff considered that the necessary information to apply IFRS 9 or unwind the application of IFRS 9 in the financial statements of an investee may not be available to the investor in a timely or cost-effective manner
- If this exception is adopted it should work both ways (investor on IAS 39 and equity accounted investees on IFRS 9 and vice versa)
- Because a reporting entity does not need to apply the overlay approach to all qualifying assets, an investor may choose to apply the overlay approach to its own qualifying assets but not those of its investee, or vice versa, without contravening the requirements to use uniform accounting policies.
- Consequently, the Staff conclude that there is no need to provide any relief for the overlay approach

Relief for investors in associates and joint ventures

Staff Analysis (Continued)

- An entity may elect to apply the overlay approach *only* when it first applies IFRS 9 therefore if it does not elect to apply the overlay approach when it first applies IFRS 9 it is not permitted to apply the overlay approach in subsequent periods.
- Consequently if it subsequently makes an investment in an associate or JV that is applying the overlay approach, the entity must ‘unwind’ that overlay accounting when applying the equity method.

Relief for investors in associates and joint ventures

Staff Recommendations

- An investor that applies IFRS 9 be permitted (but not required) to retain the IAS 39 accounting used by any associate or JV that applies the temporary exemption, and an investor that applies the temporary exemption be permitted (but not required) to retain IFRS 9 accounting used by any associate or JV
- The relief should be **available on an investment-by-investment basis**
- **Investor to reproduce, in its financial statements, the disclosures** required to be provided in the IFRS financial statements of investees that have applied either the temporary exemption or the overlay approach
- Investor to present the **amounts disclosed for individually material investees be those included in the financial statements of the investee**, not the investor's share of those amounts, and aggregate amounts disclosed for individually immaterial investees that are material in aggregate are the investor's share of those amounts included by applying the equity method.

Relief for investors in associates and joint ventures

IASB discussions and tentative decision

- A Board member stated that she supported the proposals on cost/benefit grounds and because there was no significant loss of information
- In response to a question asked by another Board member, the Staff confirmed that the **proposed disclosures would be required even if both the investor and the investee were applying the overlay approach**
- A Board member stated that the Standard should make it clear that the judgements in respect of the relief should be based on the facts and circumstances, that it must be difficult to get information from the investee, and that it was not a free choice. Another Board member disagreed with this view as she felt that it would be quite a nuanced decision
- In response to a question asked by a Board member the Staff confirmed that **the option to use the relief would be irrevocable.**

Tentative decision

- The Board unanimously approved the Staff recommendation.

Applicability of the overlay approach and the deferral method for first-time adopters of IFRS (FTAs)

Staff Analysis

- Some FTAs are not in a significantly different position compared to existing IFRS preparers because those FTAs previously applied requirements for financial instruments under national GAAP that are not significantly different to IFRS

- An FTA that applies national GAAP that is significantly different to IFRS is unlikely to apply the temporary exemption

- There is a fine balance between the reasons for prohibiting FTAs from applying the temporary exemption and the overlay approach and for permitting FTAs to apply these approaches in some circumstances

Applicability of the overlay approach and the deferral method for first-time adopters of IFRS

Staff Recommendation

Modify the proposals in the ED so that:

- an **FTA is permitted to apply the temporary exemption when the FTA meets the qualifying criteria**. An FTA must use the carrying **amounts of liabilities applying applicable IFRS** in assessing whether it meets the predominance criterion on the date of assessment; and
- an **FTA is permitted to apply the overlay approach** to qualifying assets. An FTA that applies the overlay approach **must restate comparative information**

Applicability of the overlay approach and the deferral method for first-time adopters of IFRS

IASB discussion and tentative decision

- There was no significant discussion on this issue.

Tentative decision

- The Board unanimously approved the Staff recommendation.

Due process and permission to ballot

IASB discussion and tentative decisions

- There was no discussion on this issue.

Tentative decisions

- The Board unanimously agreed that the amendments to IFRS 4 should be finalised without re-exposure
- The Board unanimously confirmed that it was satisfied that the due process requirements have been met and that it has undertaken sufficient consultation and analysis to begin the balloting process for the amendments
- One Board member intends to dissent from the publication of the amendments because she considers that information would be lost as a consequence of not implementing IFRS 9 for all reporting entitles

Next step: publication of an amendment to IFRS 4

- The Staff stated that they expect to publish in September 2016.

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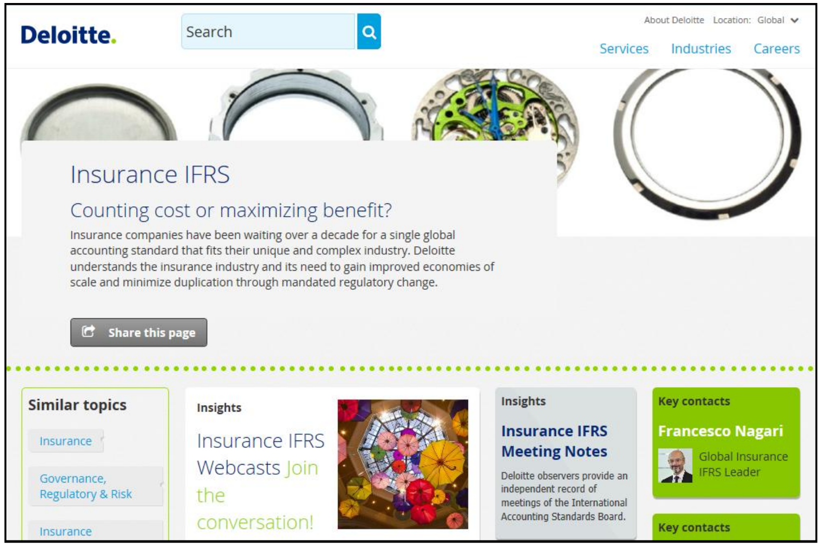

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