

Summary of EFRAG meetings held in October - November 2010

On 19 and 29 October 2010, EFRAG held meetings by public conference call to discuss:

- IASB Exposure Draft *Revenue from Contracts with Customers*
- IASB Exposure Draft *Severe Hyperinflation (Proposed amendments to IFRS 1)*
- IASB Exposure Draft *Removal of Fixed Dates for First-time Adopters (Proposed amendments to IFRS 1)*
- IFRS Interpretations Committee tentative agenda decision *IAS 36 Impairment of Assets — Calculation of value in use*.

On 8-10 November 2010, EFRAG held its monthly meeting and discussed:

- Joint EFRAG-IASB meeting
- IASB project *Annual Improvements 2009-2011*
- IASB project *Joint Arrangements*
- IASB project *Hedge Accounting*
- Follow up on issues raised during the finalisation of the EFRAG comment letter to the FASB on its proposals on accounting for financial instruments
- IASB Request for Views on *Effective Dates and Transition Methods*
- IASB Amendments to IFRS 7 *Disclosures – Transfers of Financial Assets*
- IASB Staff Draft of forthcoming IFRS *Consolidated Financial Statements*
- IASB project *Investment Entities*
- EFRAG Proactive project *Disclosure Framework*
- Educational session *User Perspective on Financial Reporting*
- IASB Exposure Draft *Deferred Tax: Recovery of Underlying Assets (Proposed amendments to IAS 12)*
- EFRAG Proactive project *Business Combinations under Common Control*
- IASB project *Conceptual Framework – Measurement*
- IASB Exposure Draft *Insurance Contracts*.

Highlights

Endorsement advice

There were no standards for endorsement released in October – November 2010.

Comment letters to the IASB

EFRAG finalised its comment letters to the IASB on the following:

- Exposure Draft *Revenue from Contracts with Customers*. The comment letter does not support the control model for revenue recognition; however, it is →

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- supportive of the IASB proposals on how to combine and segment contracts for accounting purposes and how to account for contract modifications (page 2).
- Exposure Draft *Removal of Fixed Dates for First-time Adopters (Proposed amendments to IFRS 1)*. The comment letter supports the proposals and the rationale for them (page 3).
 - Exposure Draft *Deferred Tax: Recovery of Underlying Assets (Proposed amendments to IAS 12)*. The comment letter supports the IASB's efforts to resolve the issue, but does not agree with the proposal to use the exception to the measurement principle in IAS 12 as a solution (page 7).
 - Staff Draft *Fair Value Measurement*. The comment letter reiterates two comments we made in our letter dated 16 October 2009, one regarding due process and the other in support of consistency and clarity of wording in IFRSs.

EFRAG invited comments on its draft comment letter to the IASB on the Exposure Draft *Severe Hyperinflation (Proposed amendments to IFRS 1)*. The draft comment letter acknowledges the IASB's responsiveness in addressing the accounting issues faced by entities emerging out of severe hyperinflation, however, raises various concerns regarding the scope and application of the proposals. The comment deadline is 22 November 2010 (page 2).

Comment letter to the IFRS Interpretations Committee

EFRAG finalised its comment letter to the IFRS Interpretations Committee on the tentative agenda decision *IAS 36 Impairment of Assets — Calculation of value in use*. The comment letter considers it inappropriate for the Interpretations Committee to create a rebuttable presumption in the wording of the agenda decision by stating that 'using the dividend discount model would rarely be appropriate', and recommends some changes to it (page 3).

IASB Exposure Draft Revenue from Contracts with Customers

During its meeting held by public conference call on 19 October 2010, EFRAG finalised its comment letter to the IASB in response to the Exposure Draft *Revenue from Contracts with Customers* (the ED).

The comment letter welcomes the work being carried out on this subject; however, it expresses concern that the ED has been issued without a thorough conceptual debate about why revenue is an important figure in the financial statements, what it should represent and why it provides useful information.

EFRAG does not support the proposed revenue recognition model, under which revenue is recognised only when control of goods and services is transferred to the customer, and considers that the IASB has not explained why the proposals would result in useful information. EFRAG believes that financial statements would be most decision-useful if revenue is considered a measure of establishing an irrevocable right to consideration, subject to continued performance, that arises as the entity fulfils a contract with the customer. However, EFRAG supports some aspects of the proposals in the ED, including the guidance on combining and segmenting contracts for the purpose of revenue recognition. In addition, EFRAG agrees with the proposals in ED on how to account for contract modifications but the supporting guidance needs to be clarified.

IASB Exposure Draft Severe Hyperinflation (Proposed amendments to IFRS 1)

During its meeting held by public conference call on 19 October, EFRAG finalised its draft comment letter in response to the IASB Exposure Draft *Severe Hyperinflation (Proposed amendment to IFRS 1)* (the ED). The ED proposes to add an exemption to IFRS 1 *First-time Adoption of International Reporting Standards* to allow an entity that emerges out of severe hyperinflation to measure assets and liabilities at

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fair value and use that fair value as the deemed cost of those assets and liabilities in the opening IFRS statement of financial position.

The draft comment letter acknowledges the IASB's responsiveness in addressing the accounting issues faced by entities emerging out of severe hyperinflation. However, EFRAG has various concerns regarding the scope and application of the proposals. The draft comment letter is available on EFRAG's website. The comment deadline is 22 November 2010.

IASB Exposure Draft *Removal of Fixed Dates for First-time Adopters* (Proposed amendments to IFRS 1)

During its meeting held by public conference call on 29 October 2010, EFRAG finalised its comment letter to the IASB in response to the Exposure Draft *Removal of Fixed Dates for First-time Adopters* (Proposed amendments to IFRS 1) (the ED). The ED proposes that certain references to fixed dates contained in IFRS 1 be changed to refer to the date of transition to IFRSs. The proposed effective date will be determined after exposure. EFRAG supports the proposals and the rationale for them as stated in the ED.

IFRS Interpretations Committee tentative agenda decision *IAS 36 Impairment of Assets – Calculation of value in use*

During its meeting held by public conference call on 29 October 2010, EFRAG finalised its comment letter to the IFRS Interpretations Committee on the tentative agenda decision on the application of a dividend discount model under *IAS 36 Impairment of Assets* for calculating value in use of a subsidiary, that is considered to be a cash-generating unit in the consolidated financial statements of a parent entity.

EFRAG believes that it is inappropriate for the Interpretations Committee to create, what appears to be, a rebuttable presumption in the wording for agenda decision by stating that 'using the dividend discount model would rarely be appropriate'. Therefore, EFRAG recommends that the wording of the agenda decision be amended to remove the words 'rarely be appropriate' and to clarify that the dividend discount model can be used by entities in the consolidated financial statements provided that it is consistent with the requirements of IAS 36.

Joint EFRAG-IASB meeting

An EFRAG delegation met with the IASB in a joint public meeting on 12 November, EFRAG TEG. A summary of the main issues discussed during the joint meeting can be found on our website.

IASB project *Annual Improvements 2009-2011*

EFRAG received an update on the latest developments in the IASB *Annual Improvements 2009-2011* project. An Exposure Draft *Improvements to IFRSs* (the ED) is expected to be issued in November 2010 and it is expected to include the following amendments:

- IFRS 1 *Clarification of borrowing costs exemption* – it is expected that the ED will propose amending IFRS 1 to clarify that borrowing costs (in respect of a qualifying asset incurred prior to the date of transition to IFRSs and accounted for under previous GAAP), should be carried over in the opening statement of financial position. Borrowing costs incurred after the date of transition that

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relate to an asset under construction at the date of transition, would be accounted for in accordance with IAS 23 *Borrowing Costs*.

- IFRS 1 *Repeat application of IFRS 1* – it is expected that the ED will propose amending IFRS 1 to clarify that an entity is required to apply that standard when the entity's most recent previous financial statement do not contain an explicit and unreserved statement of compliance with IFRS, even if the entity had applied IFRS in a previous reporting period.
- IAS 1 *Comparatives in financial statements* – it is expected that the ED will propose amending IAS 1 to clarify that additional financial statement information need not be presented in the form of a complete set of financial statements for periods beyond the minimum requirements because the information would be presented voluntarily.
- IAS 16 *Classification of servicing equipment* – it is expected that the ED will propose amending IAS 16 to clarify that servicing equipment should be recognised as property, plant and equipment if it is used for more than one period, otherwise it should be recognised as inventory.
- IAS 32 *Income tax consequences of distributions* – it is expected that the ED will propose amending IAS 32 to clarify that income tax relating to distributions to holders of an equity instrument should be accounted for in accordance with IAS 12 *Income Taxes*.
- IAS 34 *Segment information for total assets* – it is expected that the ED will propose amending IAS 34 to make the requirements in respect of segment information about total assets consistent with the requirements in IFRS 8 *Operating Segments*, i.e., to require disclosure only when information about total assets is regularly provided to the chief operating decision maker.

EFRAG held an initial discussion of the forthcoming proposals, and expressed tentative support for the amendments, subject to the final drafting of the ED. EFRAG is planning to discuss its draft comment letter on the ED at its December 2010 meeting.

IASB project *Joint Arrangements*

EFRAG received an update on the latest developments in the IASB project *Joint Arrangements*, which focused on the expected changes to the proposals included in the Exposure Draft *Joint Arrangements* (the ED) as a result of the Board's redeliberations. In view of the expected forthcoming IFRS, EFRAG also reiterated its key concerns expressed in the comment letter on the ED issued in February 2008. No decisions were taken.

IASB project *Hedge Accounting*

EFRAG staff updated the members on the developments of the IASB *Hedge Accounting* project focusing on the IASB's tentative decisions in respect of hedge accounting for individual items and closed portfolios. The IASB is finalising the discussions on the requirements for a general hedge accounting model and it is expected that an exposure draft will be issued in December 2010.

EFRAG did not make any decisions at this meeting and is planning to continue discussing hedge accounting at its December 2010 meeting.

Follow up on issues raised during the finalisation of the EFRAG comment letter to the FASB on its proposals on accounting for financial instruments

When EFRAG discussed its comment letter in response to the IASB's request for views on the FASB proposals on accounting for financial instruments, EFRAG considered the need for an in-depth analysis of how so called 'illiquid instruments' should be measured. EFRAG agreed in its meeting on 22 September, when it finalised the comment letter to the FASB, that it would not deliberate on the

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issue before undertaking a more detailed analysis.

EFRAG staff analysed the concerns expressed by constituents that 'illiquid' financial instruments should be measured at fair value. EFRAG discussed the role that reliability should play in cases of significant valuation uncertainty, the role of an active market in the context of the classification of a financial instrument and the role of disclosure. EFRAG considered that while fair value measurement could generate significant valuation uncertainty when markets are stressed, cost-based measurements were not relevant for derivatives and equity instruments. EFRAG considered that in presence of significant valuation uncertainty, adding specific disclosures was a more promising approach than requiring measurement at cost or separate presentation of the changes in fair value in 'other comprehensive income'. However, such disclosures should focus on both level 2 and level 3 fair value measurements. EFRAG concluded that no subsequent steps needed to be taken on the issue.

IASB Request for Views on *Effective Dates and Transition Methods*

In October 2010, the IASB issued a *Request for Views Effective dates and Transition Methods*. In view of planned completion of a number of major projects in 2011, including *Financial Instruments, Leases, Revenue from Contract with Customers and Insurance Contracts*, the IASB seeks views of constituents on whether and how to sequence effective dates in order to reduce the burden to interested parties.

EFRAG held its preliminary discussion of advantages and disadvantages of having a single effective date for all new major standards and on appropriateness of early application. EFRAG is planning to discuss its draft comment letter in response to the request for views on its conference call on 17 November 2010.

IASB Amendments to IFRS 7 *Disclosures - Transfers of Financial Assets*

In October 2010, the IASB issued an amendment to the derecognition disclosure requirements of IFRS 7 *Financial Instruments: Disclosure*. EFRAG held a preliminary discussion of the amendment with a view to drafting its endorsement advice. No decisions were taken at this meeting. EFRAG will be consulting on the subject with its various working groups, including the User Panel, the Financial Instruments Working Group and the Insurance Advisory Working Group. EFRAG is also planning to reach out to banking regulators to understand their views on the amendment. EFRAG is expecting to discuss its draft endorsement advice at its December 2010 meeting.

IASB Staff Draft of forthcoming IFRS *Consolidated Financial Statements*

EFRAG discussed the recently published IASB Staff Draft of the forthcoming IFRS *Consolidated Financial Statements* (the Staff Draft) focusing on the major changes made to the proposals included in the Exposure Draft *Consolidated Financial Statements* (the ED). EFRAG also reviewed its key concerns in respect of the proposals in the ED and considered whether, and to what extent, these concerns have been addressed by the IASB.

One of the key concerns expressed in the EFRAG's comment letter on the ED related to the proposed consolidation principle, as EFRAG believed that it would not always result in the right entities being consolidated and the right ones being off-balance sheet. The Staff Draft retained the proposed consolidation principle, but clarified some aspects of its application. EFRAG tentatively re-affirmed its concerns, particularly in respect of the IASB assertion in its basis for conclusions, that no

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auto-pilot vehicles exist. EFRAG noted that in some cases, where there is no decision making that would significantly affect the returns of the structured entity, such entities would remain unconsolidated, because the power element of the control definition may not be satisfied. EFRAG also tentatively re-affirmed its position that the proposals require further field-testing.

IASB project *Investment Entities*

EFRAG received an update on the latest developments in the IASB project *Investment Entities*. An Exposure Draft on this topic is expected at the end of 2010 or early 2011. No decisions were taken.

EFRAG Proactive project *Disclosure Framework*

EFRAG staff provided an update on the proactive project *Disclosure Framework* and asked EFRAG members for their views on the tentative set of draft principles, so staff can proceed with further work on the project. The following key points were agreed during the discussion:

- complexity should be reduced and notes should provide information only about events that have impacted or may have an impact on amounts reported in the financial statements;
- some disclosure requirements result in useful information but their location may be more appropriate outside the financial statements. This could be the case for disclosures about certain types of risk or about stewardship of management.

The draft proposals developed by the joint staff are expected to be discussed by the Advisory Panel at its December 2010 meeting.

Educational session *User Perspective on Financial Reporting*

EFRAG received a presentation about how investors use financial statements and what might be changed to ensure that the information provided to users was properly understood. The presentation was made by Alison Thomas, Director at PricewaterhouseCoopers, who leads the international work on Corporate Reporting User Forum (CRUF).

It was generally felt that there was an ‘expectations gap’ between what analysts expect to find and what the financial statements provide. This might have adverse affects on the cost of capital. Many significant changes to accounting literature were being proposed by global standard setters. It was therefore necessary to clearly set out the ‘before and after’ implications of those changes. Users were generally not accountants, and therefore needed to focus more on their use of the data (the models that they are trying to populate), the economics of the transaction under consideration rather than highly detailed accounting concepts. Other user concerns were:

- Accountants and investors can use the same terms in different ways. The jargon of the standard setters often demands a narrower definition of words than common parlance would require. To avoid talking at cross-purposes, it is important to be very clear on the definition of the key terms used.
- When surveying investment professionals, it is helpful to focus on analysts’ use of the data and the economics of the transaction under review rather than assuming a detailed knowledge of technical accounting topics. Worked examples, where possible, can greatly facilitate a debate. Where more detailed technical questions are posed, offering context to the question and clarity on terms used

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can be helpful. Similarly with round table discussions, engagement by mainstream investors will be limited to those who are technically trained unless assurance is given in advance that the focus of the discussion will be on their use of data and the challenges with the existing data set, rather than their knowledge of conceptual accounting issues.

Some EFRAG members stressed the need for further research in user needs in order to bridge the perceived 'expectation gap' between what preparers provide and what users want.

IASB Exposure Draft *Deferred Tax: Recovery of Underlying Assets (Proposed amendments to IAS 12)*

EFRAG finalised its comment letter to the IASB in response to the Exposure Draft *Deferred Tax: Recovery of Underlying Assets (Proposed amendments to IAS 12)* (the ED). The proposed amendments introduce an exception to the measurement principles in IAS 12. The purpose of the proposed amendments is to provide a practical approach in those cases where it is difficult or subjective to determine the manner in which an entity expects to recover the carrying amount of its assets.

EFRAG agrees that the existing IAS 12 lacks guidance on the accounting for income tax in relation to assets for which the tax consequences depend on the way the carrying amount of the underlying asset is recovered. Therefore, the comment letter supports the IASB in its efforts to address the issue.

However, EFRAG disagrees with the proposal to use an exception to the measurement principles in IAS 12 as a solution and recommends that the issue be addressed by extending application guidance on the measurement principle. EFRAG believes that this approach would result in the right answer based on the 'manner of recovery' of the underlying asset.

EFRAG Proactive project *Business Combinations under Common Control*

EFRAG discussed an issues paper based on the various draft chapters of a forthcoming Discussion Paper *Business Combinations under Common Control* (the DP), focusing on the following:

- *Differences between business combinations under common control and not under common control* – the draft chapter in the DP explores the differences between these two types of business combinations to explain the scope exemption in IFRS 3 *Business Combinations*. EFRAG was broadly supportive of the differences identified.
- *Impact of the revised Framework on accounting for business combinations under common control* – the draft chapter analyses how the objective of financial reporting, the reporting entity concept and the qualitative characteristics could provide the basis for developing an accounting solution to business combinations under common control for the transferee. It proposes that economic substance may be a key determining factor that would trigger remeasurement of assets acquired and liabilities assumed in a business combination under common control. EFRAG was broadly supportive of an analysis based on the needs of capital providers as primary users; however, some members expressed concerns about economic substance being a key determining factor triggering remeasurement.

EFRAG is expected to continue discussing this proactive project at its December 2010 meeting.

IASB project *Conceptual Framework - Measurement*

The IASB and the FASB are working jointly on the Measurement phase of the Conceptual Framework project. The objective of this phase is to develop guidance for selecting measurement bases that satisfies the objectives and qualitative characteristics of financial reporting.

The Canadian Standard Setter and the French Standard Setter undertook their own research in this area with the intention to contribute to the work being carried out by the IASB and the FASB. EFRAG members considered developments in the project focusing, in particular, on the output produced by the Canadian and the French Standard Setter.

While no decisions were made, some key messages expressed during the discussion included the following:

- The measurement guidance in the Conceptual Framework should be reflective of the fact that it is inevitable that there will be a need for selecting among different measurement attributes to report for economic activities of entities. Members noted that the business model of an entity and market activity as examples of factors that may influence the choice of a measurement attribute in particular circumstances.
- In establishing measurement principle, it is important to recognise that the financial reporting and financial analysis serve different roles. Financial statements should provide useful information, but they cannot substitute the work of financial analysts. Thus, even though financial analysts need to determine a market value of an entity, this does not necessarily mean that market prices are the only relevant attributes for measuring items in financial statements.

IASB Exposure Draft *Insurance Contracts*

EFRAG received an update on the outreach activities undertaken by its staff on the draft comment letter on the IASB Exposure Draft *Insurance Contracts* (the ED). The outreach activities included meetings with constituents in various locations and meetings of the EFRAG Insurance Accounting Working Group.

The feedback received during the outreach shows that many constituents are still concerned about the impact of the proposals in the ED on the financial reporting of insurance contracts. The key concerns relate to accounting mismatches and the presentation of the performance of an insurer. As a result, the insurance industry was considering alternative models for insurance contract accounting.

EFRAG also discussed accounting for reinsurance contracts by the insurer. The ED proposes that an insurer should recognise a gain if a premium paid for reinsurance of a contract was lower than the fulfilment cash flows that are reinsured; but it would not record a loss if the premium paid for reinsurance exceeded the fulfilment cash flows that are reinsured plus the corresponding residual margin. EFRAG does not support this proposal, because it is inconsistent with the approach for the measurement of an insurance liability.

EFRAG is planning to finalise its comment letter to the IASB on the ED at its December 2010 meeting.