

May 2011

Summary of EFRAG meetings held from April to May 2011

On 29 April 2011, EFRAG held meetings by public conference call to finalise its comment letter on:

- IASB Exposure Draft *Offsetting Financial Assets and Financial Liabilities*.

On 12 and 13 May 2011, EFRAG held its monthly meeting and discussed the following:

- Planning for actions needed to support future assessment of IFRS 10 *Consolidation*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IFRS 13 *Fair Value Measurement*, revised IAS 27 *Separate Financial Statements* and revised IAS 28 *Investments in Associates and Joint Ventures*
- IASB re-deliberations in the project *Revenue from Contracts with Customers*
- IASB re-deliberations in the project *Leases*
- IASB Project *Financial Instruments*
- EFRAG Proactive project *Financial Reporting for Corporate Income Tax*
- EFRAG Proactive project *Business Combinations under Common Control*.

Highlights

Comment letters to the IASB

EFRAG finalised its comment letter to the IASB in response to the Exposure Draft *Offsetting Financial Assets and Financial Liabilities*.

The comment letter welcomes the IASB and the FASB efforts to develop joint proposals for converged requirements for offsetting financial assets and liabilities. EFRAG supports the IASB decision to use, as a basis for the converged requirements, the existing guidance for offsetting financial assets and financial liabilities in IAS 32 *Financial Instruments: Presentation*, with some refinements (page 1).

IASB Exposure Draft Offsetting Financial Assets and Financial Liabilities

During its meeting, held by public conference call on 29 April 2011, EFRAG finalised its comment letter to the IASB in response to the Exposure Draft *Offsetting Financial Assets and Financial Liabilities*. →

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In its final letter, EFRAG welcomes the IASB and the FASB efforts to develop joint proposals for converged requirements for offsetting financial assets and liabilities. EFRAG supports the IASB decision to use, as a basis for the converged requirements, the existing guidance for offsetting financial assets and financial liabilities in IAS 32 *Financial instruments: Presentation*, with some amendments.

The comment letter supports the proposal to clarify that the right to set off the financial asset and the financial liability must be unconditional and legally enforceable in all circumstances. The comment letter also broadly supports the proposal to specify the disclosure requirements about rights to offset financial assets and financial liabilities of an entity and the related arrangements, including information about collateral and master netting arrangements. However, EFRAG recommends the IASB to reconsider the amendments to IAS 32 in relation to ‘simultaneous settlement’ and the treatment of cash collateral and margin accounts, to adopt a more principles-based approach.

Furthermore, EFRAG urges the IASB to consider the proposals in the ED in the context of the existing disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*, taking into account the disclosure proposals made in other consultation documents in respect of accounting for financial instruments. This is needed to ensure that the level of guidance included in the disclosure standard remains consistent and balanced across topics. Finally, EFRAG disagrees with the requirement to disclose grossed-up information about financial instruments that meet the offsetting criteria and that have been offset on the face of the statement of financial position.

Planning for endorsement process

At its May 2011 meeting, EFRAG held an initial planning discussion in relation to the future assessment of IFRS 10 *Consolidation*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IFRS 13 *Fair Value Measurement*, revised IAS 27 *Separate Financial Statements* and revised IAS 28 *Investments in Associates and Joint Ventures*. EFRAG gave direction to the staff, as to which issues to focus on, and the outreach work to be performed in order to support that assessment.

IASB re-deliberations in the project *Revenue from Contracts with Customers*

EFRAG received an update on the feedback received from European constituents in relation to the IASB’s re-deliberations of the proposals included in the Exposure Draft *Revenue from Contract with Customers* (the ED). The feedback was received as part of the European outreach on the IASB’s main projects. It was noted in a number of meetings, that European constituents expressed concerns that the proposals might result in revenue being recognised, even when an entity had not established a right to receive consideration subject to continued performance; for example, when an entity satisfies a performance obligation continuously by creating or enhancing an asset that has no alternative use other than serving the customer under the contract. It was also noted that some industries (for example, the software industry) were still concerned that, under the new proposals, they would not be able to recognise revenue continuously as work progresses (i.e., using the percentage of completion method).

EFRAG also discussed the latest tentative decisions, which the IASB made in relation to this project, including the following:

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- *Disaggregation of contracts:* there were concerns amongst the construction industry that the disaggregation proposals in the ED would result in numerous performance obligations. To address these concerns, the IASB has tentatively decided that a contract, which includes an “integration service”, should not be disaggregated, but accounted for as a single performance obligation. Participants in EFRAG outreach events have welcomed the IASB’s decision, but expressed concerns that the notion of an “integration service” may be subject to various interpretations in practice. EFRAG discussed whether this criterion would result in a consistent application, and identified a need for supporting guidance.
- *Time value of money under the percentage of completion method:* during the outreach meetings, some constituents raised concerns about practical difficulties surrounding application of the time value of money proposals under the percentage of completion method. EFRAG tentatively decided recommending the IASB to perform further work on this issue.
- *Cross-cutting issues:* EFRAG identified fulfilment costs and unbundling of contracts as cross-cutting issues that will need further consideration.

EFRAG will continue to follow closely the IASB re-deliberations and will consider the full feedback received from the European outreach once it is finalised.

IASB re-deliberations in the project *Leases*

EFRAG received an update on the feedback received from European constituents in relation to the IASB’s re-deliberations of the proposals included in the Exposure Draft *Leases* (the ED). The feedback was received as part of the European outreach on the IASB’s main projects. The following issues were discussed:

- *Definition of a lease:* in April 2011, the IASB tentatively decided that a specified asset is an asset explicitly or implicitly identifiable, for which the lessor does not have a substantive right of replacement. It also introduced the notion of a separable and inseparable asset from the provision of a service specified in a contract. No specific comments or concerns in relation to the new proposals on the definition of a lease were raised during the outreach meetings.
- *Two types of leases:* the IASB has tentatively decided to differentiate between two types of leases; finance leases and other-than-finance leases. The IASB has tentatively decided that for other-than-finance leases, the impact on the profit or loss of the amortisation of the right-of-use and interest cost should be consistent with the result of the operating lease accounting in IAS 17 *Leases*. Generally, participants shared the IASB’s decision that not all leases are financing arrangements and viewed retaining the current model in IAS 17 as appropriate. Concerns were raised about the usefulness of the information produced under the modified annuity-based amortisation method. It was also considered to be too complex to apply. Among the few constituents, who expressed a preference for a new model, the views were split as to whether it should be based on the right of use model applied to all leases (i.e., the proposals in the original exposure draft) or on the modified annuity-based amortisation method applied to other than finance leases (i.e., the new proposals).
- *Options:* the IASB has tentatively decided that amounts due under options that give a significant economic incentive to exercise should be included in the measurement of assets and liabilities. The new proposals on options were considered an improvement compared to the ED. However, participants indicated that only liabilities (i.e., genuinely unavoidable payments) should be recognised in the balance sheet.

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EFRAG will continue to follow closely the IASB re-deliberations and will consider the full feedback received from the European outreach once it is finalised.

IASB Project *Financial Instruments*

EFRAG received an update on the latest developments in relation to the IASB *Financial Instruments* project. The IASB is re-deliberating its Exposure Draft *Hedge Accounting*, the FASB is re-deliberating classification and measurement of financial instruments, and the two Boards are jointly re-deliberating their proposals on impairment of financial assets, on the basis of the feedback received on the supplementary document to Exposure Draft *Financial Instruments: Impairment*.

EFRAG commended the two Boards on the recently issued progress report on the convergence work and the IASB's revised project plan. The two Boards confirmed their commitment to the goal of completing the work on the Financial Instruments project during the second half of 2011. The additional time will be used to consult stakeholders and address their concerns and issues. The IASB will also seek views on the FASB conclusions on classification and measurement. In addition, the IASB plans to develop its proposals on portfolio hedge accounting ("macro hedging") in future meetings before it finalises the general hedge accounting requirements. The IASB expects to publish an exposure draft in the second half of 2011.

EFRAG did not take any decisions at this meeting, but noted the interaction between this project and the IASB project *Insurance Contracts* and considered that the two Boards are at different stages of development of the respective standards, particularly in relation to hedge accounting and insurance contracts.

EFRAG Proactive project *Financial Reporting for Corporate Income Tax*

At its May 2011 meeting, EFRAG reviewed a working draft of a Discussion Paper, which is being developed as part of the first phase of the project on accounting for corporate income tax, conducted jointly by EFRAG and the national standard setters of the UK (ASB) and Germany (GASB). The ASB and the GASB had considered the working draft of the Discussion Paper, subject to drafting, at their recent Board meetings.

The parties involved in the project agreed to adopt a phased approach commencing with an analysis of the practical issues in the current application of IAS 12 *Income Taxes*. It was agreed to issue a short Discussion Paper, in order to outline the practice issues arising from the application of IAS 12 and to focus on the usefulness of the information produced under it. The objective of the Discussion Paper is to support a public consultation aiming at identifying what causes problems and/or needs improvement in IAS 12. It is also aiming at seeking views from the public on the possible ways to solve the issues identified, and hence receiving directions for further work in the second phase of the project.

EFRAG broadly supported the content of the working draft that addressed the implementation and practice problems arising from IAS 12, and user concerns about information produced under its requirements. EFRAG also supported that the first phase of the project should be the opportunity to seek views on the possible ways to solve the issues identified. However, EFRAG noted that whilst participants could have formed views on the problems caused by IAS 12, they might not necessarily have developed solutions to solve these problems. Therefore, EFRAG concluded that the Discussion Paper should be divided into two parts, subject to two invitations for comments, which will be issued in parallel. →

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The first part will focus on problems arising from IAS 12, and the second part will discuss possible ways forward. The constituents would be welcome to provide input on the identification of problems only (i.e., first part of the Discussion Paper), if they decide to do so. EFRAG also expressed the view that the second part should evenly discuss possible ways forward, rather than identifying any preferred approach. Input from the constituents is necessary before getting to that stage.

EFRAG Proactive project *Business Combinations under Common Control*

EFRAG and the national standard setter of Italy (OIC), in participation of the national standard setter of France (ANC), are continuing working together on a proactive project on Business Combinations under Common Control. The objective of the May 2011 meeting was to further articulate one of the perspectives in the forthcoming discussion paper that considers the needs of users in determining how Business Combinations under Common Control transactions should be measured.

At the April 2011 meeting, EFRAG suggested that the principle in this view should focus on whether or not a Business Combination under Common Control changes the relative economic interests of those who have a claim against the combining entities (also referred to as ‘a change in economic interests’). If this is the case, then such a change is likely to be relevant to various groups of users of the financial statements, including existing and potential equity investors, lenders and other creditors. In this instance, IFRS 3 *Business Combinations* should apply.

EFRAG decided that a change in economic interests would be relevant to the various groups of users once there has been a change in the ability of the reporting entity to meet existing claims against the combining entities.

The project team will finalise the drafting of the forthcoming discussion paper and is to present it to EFRAG at its July 2011 meeting.