

May

Summary of EFRAG meetings held in April - May 2010

On 23 April 2010, EFRAG held a TEG meeting by public conference call to discuss:

- IASB Discussion Paper *Extractive Activities*.

On 5-7 May 2010, EFRAG held its monthly TEG meeting and discussed:

- IASB Exposure Draft *Defined Benefit Plans (Proposed amendments to IAS 19)*
- IASB project *Financial Statements Presentation (Replacement of IAS 1 and IAS 7)*
- IASB project *Discontinued Operations (Re-exposure of Amendments to IFRS 5)*
- IASB project *Annual Improvements 2008-2010*
- IFRS for SMEs and the European Accounting Directives
- IASB project *Consolidation*
- IASB Exposure Draft *Financial Instruments: Amortised Cost and Impairment*
- IASB project *Insurance Contracts*
- IASB project *Presentation of Items of Other Comprehensive Income*
- IASB project *Financial Liabilities*
- IASB project *Revenue Recognition: Revenue from Contracts with Customers*.

Highlights

Endorsement advice

There were no final documents for endorsement discussed in April – May 2010.

Comment letters to the IASB

EFRAG invited comments on its draft comment letter to the IASB on the Discussion Paper *Extractive Activities*. The draft comment letter supports the initiative to provide guidance for extractive activities, however urges the IASB to consider if current IFRSs can be applied to them before developing a separate model. The comments deadline is 2 July 2010 (page 1).

IASB Discussion Paper *Extractive Activities*

During its TEG meeting held by public conference call on 23 April 2010, EFRAG finalised its draft comment letter in response to the IASB Discussion Paper *Extractive Activities* (the DP). The draft comment letter supports the initiative to provide guidance for extractive activities. However, it urges the IASB to consider if current IFRSs can be applied to extractive activities, albeit with application guidance where necessary, before a separate accounting model is developed. The draft comment letter is available on EFRAG's website. The comment deadline is 2 July 2010.

EFRAG Update is published as a convenience for EFRAG's constituents. All conclusions reported are tentative and may be changed or modified at future meetings.

IASB Exposure Draft *Defined Benefit Plans (Proposed amendments to IAS 19)*

EFRAG discussed the IASB Exposure Draft Defined Benefit Plans (Proposed amendments to IAS 19) (the ED) with a view to developing its draft comment letter. EFRAG tentatively expressed support for the project as a short-term solution for pension accounting pending the debate on fundamental issues related to both pensions and performance reporting. In addition, EFRAG tentatively supported the following proposals in the ED:

- immediate recognition of changes in the defined benefit obligation and in the fair value of plan assets (i.e., elimination of the existing “corridor approach”);
- immediate recognition of the unvested past service costs in the period in which the related plan amendment occurs. Current IAS 19 requires recognition of the unvested past service costs over the remaining vesting period;
- disaggregation of the defined benefit costs into different components: service cost (recognised in profit or loss), finance cost (recognised as part of finance costs in profit or loss), and remeasurements (recognised in other comprehensive income without recycling);
- calculation of net interest income and expense on the net of the defined benefit obligation and plan assets based on the rate for high quality corporate bonds. Current IAS 19 requires use of the expected rate of return on plan assets. However, EFRAG acknowledges practical application difficulties in countries without developed financial markets;
- disclosure objectives and requirements.

EFRAG plans to finalise its draft comment letter at a public conference call scheduled for 17 May 2010.

IASB project *Financial Statements Presentation (Replacement of IAS 1 and IAS 7)*

EFRAG discussed the forthcoming IASB Exposure Draft *Financial Statements Presentation* (the ED). The discussion focused on the following key concerns that were raised previously in EFRAG’s comment letter on the Discussion Paper *Preliminary Views on Financial Statements Presentation* published by the IASB in October 2008 (the DP):

- *Direct operating cash flows* – it is expected that in addition to the proposal in the DP to require the direct method for presenting operating cash flows, the ED will propose an indirect reconciliation of operating profit to operating cash flows, which would follow immediately the Statement of Cash Flows (SCF). EFRAG tentatively reaffirmed its view that the current option to present operating cash flows using the indirect method should be retained. In its opinion, the IASB has not so far provided compelling arguments why an indirect cash flow statement is less decision-useful and has not reasonably justified why the change is needed.
- *Classification approach based on functional activities* – the DP proposed a “management approach” to classification. Consistent with the EFRAG comments on the DP, it is expected that the ED would clarify that classification approach based on functional activities is a requirement and is not at management’s discretion. EFRAG tentatively reaffirmed that it is supportive of the classification reflecting the use of assets and liabilities in the business.
- *Cohesiveness* – the ED is expected to propose that cohesiveness as a principle is achieved at a category level rather than at the item-by-item, as originally proposed in the DP. EFRAG is tentatively supportive of this development but reiterated its concerns that it would not be allowed to classify flows (changes) arising from a single item in the Statement of Financial Position (SFP) into different categories in the Statement of Comprehensive Income (SCI) and in the SCF, although some assets and liabilities may give rise to multiple items of different nature (e.g., post-employment benefits).
- *Disaggregation on the face of the primary statements* – it is expected that the ED would permit much of the disaggregated information to be presented in the notes, however EFRAG tentatively raised concerns about the level of detail required on the face of the primary statements. →

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- *Net debt reconciliation* – the ED is expected to require a reconciliation of the “net debt” in a single note. EFRAG tentatively raised concerns that items, which usually form part of the net debt reconciliation, will not be classified in the same section on the face of the SFP. For example, cash and short-term investments would not be included in the financing section and instead classified in the business section.
- *Analysis of changes in balances of select items (former reconciliation schedule)* – it is expected that the ED will replace the detailed line-by-line reconciliation schedule proposed in the DP with an analysis of changes in balances of *select* assets and liabilities. This analysis would be presented in the relevant notes of each select asset or liability. EFRAG tentatively raised concerns that the proposal might result in the reconciliation for nearly all items displayed on the face of the SFP.
- *Comparative information for changes in classification following a change in use* – the ED is expected to require reclassification of comparative information if an entity makes a change in presentation following a change in use or function of an asset or liability. EFRAG tentatively disagreed with the proposal noting that it is inconsistent with the classification principle, which is based on the functional activities. If the underlying principle is that financial statements reflect the functions, in which assets and liabilities are used, and the functions of a particular asset are different in different periods, then this should be reflected in the financial statements.
- *Remeasurements* – the ED is expected to require disclosure of remeasurements in a single note. EFRAG tentatively raised concerns about the proposed definition of a remeasurement and noted that the objective of this disclosure should be clearly articulated.

IASB project *Discontinued Operations (Re-exposure of Amendments to IFRS 5)*

EFRAG discussed its response to the forthcoming IASB Exposure Draft *Discontinued Operations (Re-exposure of Amendments to IFRS 5)* (the 2010 ED). The following key messages were tentatively agreed for the draft comment letter:

- *Definition of a “discontinued operation”* – EFRAG tentatively supports the forthcoming proposal to use the current definition of a discontinued operation in IFRS 5 as a converged definition in IFRS and U.S. GAAP.
- *Continuing involvement disclosure* – EFRAG observed that disclosures about unrecognised contractual commitments, financial guarantees, the splitting or merging of a post-employment benefit plan and an option to repurchase a discontinued operation are already required by other standards if material. EFRAG is not supportive of the duplication of disclosures. As an alternative, EFRAG believes that it would be useful to disclose the nature of the item giving rise to continuing involvement in the note about a discontinued operation and then include a reference to the relevant note in the financial statements, which provides information about that item.
- *Disclosures on individually material components that do not meet the definition of a discontinued operation* – EFRAG tentatively decided to reiterate its position that the scope of the disclosures about components of an entity that have been (or will be) disposed of should be limited to items that are presented separately as discontinued operations in the income statement. EFRAG, therefore, would not support the proposal in the ED.

EFRAG plans to prepare its draft comment letter once the ED is issued.

IASB project *Annual Improvements 2008-2010*

EFRAG held a preliminary discussion of the invitation to comment on the *Improvements to IFRSs 2010*. No decisions were taken at this meeting. EFRAG will continue the discussion at a public conference call scheduled for 17 May 2010.

In November 2009, the European Commission asked EFRAG's advice on whether aspects of IFRS for SMEs could be incompatible with the EU Accounting Directives. In March 2010 EFRAG issued a draft letter for comments. EFRAG analysed the comments received and tentatively concluded that the following requirements of IFRS for SMEs are *not* compatible with the EU Accounting Directives:

- the prohibition to present or describe any item of income and expense as “extraordinary items” in the statement of comprehensive income or in the notes;
- the requirement to measure some financial instruments within the scope of section 12 of the IFRS for SMEs at fair value;
- the prohibition to present unpaid capital as an asset;
- the requirement to presume the ten-years useful life of goodwill if an entity is unable to make a reliable estimate of its useful life;
- the requirement to recognise immediately any negative goodwill in profit or loss;
- the prohibition to reverse an impairment loss recognised for goodwill.

In its letter to the European Commission EFRAG will emphasise that the list of incompatible requirements should be read in the context of the limitations of the study. Moreover, EFRAG will emphasise that the working paper reflecting EFRAG's complete assessment of all the requirements of the IFRS for SMEs is an integral part of the letter.

In addition to its letter to the European Commission, EFRAG will issue a feedback statement, which will list other items mentioned by constituents in their comment letters as incompatible with the EU Accounting Directives and will outline the reasons for not including those in the letter to the European Commission. The letter, the working paper and the feedback statement will be available on EFRAG's website in May 2010.

IASB project *Consolidation*

The IASB staff updated EFRAG members on the latest developments of the IASB's project on consolidation. The IASB has reached the tentative decision that investment companies should recognise their controlled investments at fair value, rather than consolidating them, if certain criteria are met. The IASB is expected to issue an exposure draft in June 2010. No decisions were taken at this meeting.

IASB Exposure Draft *Financial Instruments: Amortised Cost and Impairment*

Representatives of the Basel Committee Accounting Task Force presented to the EFRAG members their proposed simplification of the IASB's expected loss model for impairment of financial assets as included in the IASB Exposure Draft *Financial Instruments: Amortised Cost and Impairment* (the ED). Although EFRAG did not express a view on the Basel proposals, the meeting served as an opportunity to understand the alternative approaches that aim to make the IASB's proposals more operational for banks. EFRAG will consider this input in finalising its comment letter on the ED.

EFRAG also considered the results of its outreach activities and decided not to amend its draft comment letter at this stage because:

- the responses largely reflect the concerns already raised in the draft comment letter;
- the alternative models proposed by respondents still require further development before detailed technical assessments can be undertaken; and
- the mechanics of the proposals are still under consideration by the Impairment Expert Advisory Panel and it would be inappropriate to draw any conclusions on the model before the discussions are finalised.

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Constituents may want to consider the summary of the results of the outreach activities, which is available on EFRAG's website, in forming their responses to the EFRAG's draft comment letter. EFRAG will also consider the responses received to the questionnaire when finalising its comment letter to the IASB during the TEG June 2010 meeting.

IASB project *Insurance Contracts*

IASB staff provided the EFRAG members with an overview of the model that has been developed by the IASB as part of its project on insurance contracts. IASB staff also highlighted the outstanding issues in relation to the forthcoming exposure draft, which is expected to be published in June or July 2010.

EFRAG also discussed the following key elements of the envisaged accounting model for insurance contracts:

- *Measurement objective ("fulfilment value")* – EFRAG is generally supportive of measurement based on fulfilment value, which is calculated using expected future cash flows, as the objective for measuring insurance contracts.
- *Four building blocks of the measurement* – EFRAG is generally supportive of the building blocks approach to measurement of insurance contracts, but is uncertain about how a risk margin could be measured reliably and, therefore, whether it should be identified separately for measurement purposes. EFRAG staff was requested to prepare a paper on risk margins for the June 2010 meeting that specifically addresses measurement methodologies and the implications of separate measurement.
- *Treatment of the residual profit margin* – EFRAG discussed whether the residual profit margin should be a static number or act as a "buffer" for subsequent changes in expected cash flows and/or the residual margin. No firm views were expressed on this point.

IASB project *Presentation of Items of Other Comprehensive Income*

EFRAG discussed its response to the forthcoming IASB Exposure Draft *Presentation of Items of Other Comprehensive Income* (the ED). The ED is expected to be issued at the end of May 2010 and it is expected to include the following proposals:

- *Single performance statement* – the ED is expected to propose eliminating the option of presenting non-owner changes in equity in two separate statements: an income statement and a statement of comprehensive income. EFRAG tentatively decided to reiterate its position that it strongly objects to the IASB's initiative to address this issue prior to finalising the discussion on fundamental issues related to performance reporting (e.g., the notion of performance, or the content of profit and loss and other comprehensive income). EFRAG also noted that this proposal would not result in any change or improvement to the current financial reporting, and therefore it does not support it. Indeed, under the current requirements if an entity chooses the option to present performance in two statements, then the statement displaying components of other comprehensive income is required to be presented immediately after the income statement. Therefore, all non-owner changes in equity are already presented together with equal prominence and items of profit or loss are already – and even better – distinguished from items of other comprehensive income.

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- *Disaggregation of other comprehensive income (OCI)* – the ED is expected to propose separate presentation of items of other comprehensive income that are reclassified to profit or loss (recyclable) and those that are not reclassified to profit or loss (non-recyclable). EFRAG understands the importance of this proposal for other IASB projects, such as Pensions and Financial Instruments, and is supportive of it. However, EFRAG believes that it would be more efficient to address this issue via the annual improvements process rather than in a separate ED.

EFRAG plans to prepare its draft comment letter once the ED is issued.

IASB project *Financial Liabilities*

EFRAG discussed tentative decisions of the IASB on classification and measurement of financial liabilities in light of developing its draft comment letter on the corresponding exposure draft, which is expected in May 2010.

EFRAG is supportive of the IASB's tentative decisions to retain bifurcation requirement for financial liabilities with embedded derivatives. It is also supportive of the tentative decision to report separately the effects of own credit risk in the fair value changes of financial liabilities designated under the fair value option.

However, EFRAG is not supportive of the IASB's "two-step approach" to recognition of the fair value changes in financial liabilities attributable to changes in own credit risk. Under this approach the fair value change in financial liabilities attributable to changes in own credit risk would be recognised in profit or loss as part of the total fair value change and then immediately transferred to other comprehensive income (OCI) with an offsetting entry to profit or loss. EFRAG believes that credit risk related changes in financial liabilities should be recognised directly in OCI. The "two-step approach" represents a change in the current use of profit or loss and OCI, and EFRAG considers that such changes should not be made prior to development of principles governing the use of OCI.

Acknowledging overall diverging views on recycling of items initially recorded in OCI, EFRAG tentatively considered that the fair value changes that are attributable to changes in own credit risk should be recycled out of OCI to profit or loss when they are realised.

IASB project *Revenue Recognition: Revenue from Contracts with Customers*

EFRAG discussed the forthcoming IASB Exposure Draft *Revenue Recognition: Revenue from Contracts with Customers* (the ED), which is expected at the beginning of June 2010. The following key issues were considered:

- *Revenue recognition based on transfer of control* – it is expected that the ED will propose recognising revenue based on transfer of control over goods or services to the customer. EFRAG tentatively reaffirmed its disagreement with the control model and reiterated its support for the activity-based model, under which revenue is recognised as entity progresses towards fulfilment of the contract and acquires an irrevocable right to receive consideration from the customer.
- *Customer perspective of control over goods or services* – it is expected that the ED will consider the transfer of control over goods or services from the customer perspective rather than from the entity's point of view. EFRAG tentatively disagreed with this proposal.
- *Segmenting contracts and identifying performance obligations* – in case of multiple deliverables, it is expected that the ED will require considering whether the transaction includes separate contracts as a first step and then as a second step to identify separate performance obligations. EFRAG tentatively questioned the two-step approach.

Future meetings

The next meeting of EFRAG TEG will take place on 8-11 June 2010.

Conference calls are scheduled for 17 May and 1 June 2010.