

July 2013

Summary of EFRAG Technical Expert Group (TEG) meeting July 2013

EFRAG TEG held a conference call on 26 June 2013 to discuss:

- IASB Exposure Draft *Leases*
- *Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)*

EFRAG TEG held a special one day meeting on 4 July 2013 to discuss:

- IASB Exposure Draft *Financial Instruments: Expected Credit Losses*
- *Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)*
- IASB Exposure Draft *Financial Instruments: Expected Credit Losses*
- *Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)*
- IASB Exposure Draft *Insurance Contracts*

From 15 to 17 July 2013 EFRAG TEG held its monthly meeting. The following topics were discussed:

- IASB Exposure Draft *Insurance Contracts*
- IASB Project *Accounting for Macro Hedging*
- IASB Exposure Draft *Financial Instruments: Expected Credit Losses*
- IASB Exposure Draft *Defined Benefit Pension Plans: Employee Contributions (Proposed Amendments to IAS 19)*
- *Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)*
- *Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)*
- IFRIC Interpretation 21 *Levies*
- IASB Exposure Draft *Agriculture: Bearer Plants (Proposed amendments to IAS 16 and IAS 40)*
- IASB Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*
- EFRAG Public Consultation *Is there a need for specific financial reporting for long-term investing activities business models?*
- EFRAG/ANC/FRC Proactive Project *The Role of the Business Model in Financial Reporting*
- EFRAG/OIC/ICAC/DASB Proactive Project *Separate Financial Statements*

Highlights

Endorsement Advice

On 4 July 2013 EFRAG published Draft Endorsement Advice on *Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)* and *Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)*. Following a comment period that was shortened at the request of the European Commission, on 15 July 2013 EFRAG submitted its Endorsement Advice letter and Effects Study report. See below for more details.

On 19 July 2013 EFRAG published its Draft Endorsement Advice on IFRIC Interpretation 21 *Leases*. Comments are requested by 2 September 2013. For more details see page 5.

Comment letters

On 8 July 2013 EFRAG published its draft comment letter on the IASB Exposure Draft *Leases*. Comments are invited by 6 September 2013. For more details see page 2.

On 9 July 2013 EFRAG published its final comment letter on the IASB Exposure Draft *Financial Instruments: Expected Credit Losses*. For more details see page 3.

On 17 July 2013 EFRAG published its final comment letter on the IASB Exposure Draft *Defined Benefit Pension Plans: Employee Contributions (Proposed Amendments to IAS 19)*. For more details see page 5.

On 17 July 2013 EFRAG published its draft comment letter on the IASB Exposure Draft *Agriculture: Bearer Plants (Proposed amendments to IAS 16 and IAS 40)*. Comments are invited by 14 October 2013. For more details see page 5.

IASB Exposure Draft *Leases*

EFRAG TEG approved the draft comment letter on the revised Exposure Draft issued by the IASB in May 2013.

In the draft comment letter, EFRAG emphasises the need to ensure that constituents have a good understanding of the objectives of the project and what economic phenomena the IASB intended to depict in the primary financial statements. EFRAG does not think that this understanding exists today, or that the right-of-use model is adequately explained.

EFRAG suggests that the IASB could consider a two-stage approach for leases: in the first phase the IASB could improve the information for users by introducing more detailed and comprehensive disclosures, and in the second phase it could reconsider the scope of the right of use model in light of developments in the Conceptual Framework discussions.

EFRAG agrees that the expected level of consumption of the benefits embedded in the underlying asset is an important element of the substance of the transaction. However, EFRAG believes that this element should discriminate between transactions to be recognised on the balance sheet and those to keep off-balance, rather than trigger a different measurement.

The draft comment letter contains two views regarding options to extend a lease:

1. An entity having an option should never be required to recognise a higher liability; or
2. That recognition is appropriate when the exercise of the option is extremely likely.

The draft comment letter also includes alternative views on how to classify leases, between type-A and type-B, and the application of fair value measurement when the underlying asset qualifies as investment property.

EFRAG also makes recommendations to improve presentation and disclosure requirements, as well as the guidance on allocation of total price between different components and variable lease payments.

Comments are requested by 6 September 2013. EFRAG, and the National Standard Setters of France, Italy, Germany and the United Kingdom, are concurrently running a field-test of the proposals, the outcomes of which will be considered with responses to EFRAG's draft comment letter.

Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)

On 11 July 2013, EFRAG issued an Invitation to Comment relating to the endorsement of the Amendments for use in the European Union and European Economic Area. It consulted its constituents both on its assessment of the Amendments against the technical criteria for the endorsement, and on its initial assessment of the costs and benefits that would arise from their implementation. Comments were requested by 11 July 2013. EFRAG alerted its constituents about the short comment period, which was requested by the European Commission to enable a rapid endorsement, by issuing a news item on 28 June 2013.

At its July meeting EFRAG TEG discussed and approved the final endorsement advice and effects study report relating to the Amendments for use in the European Union and European Economic Area.

EFRAG supports the adoption of the Amendments and recommends their endorsement. EFRAG's recommendation is explained in the letter to the European Commission, the accompanying Basis for Conclusions and the Effects Study Report on the costs and benefits of implementing the Amendments.

IASB Exposure Draft *Financial Instruments: Expected Credit Losses*

At its meeting on 4 July, EFRAG TEG approved a final comment letter in response to the Exposure Draft. In its comment letter, EFRAG notes that conceptually it supported the integrated effective interest rate approach in the 2009 ED and supported the time proportionate approach in the Supplementary Document; however, EFRAG acknowledges the significant operational concerns expressed by constituents regarding the implementation of those approaches.

EFRAG's assessment is that the proposed approach could strike an acceptable balance between the cost of implementation and the underlying economics while meeting the need to provide earlier for expected credit losses as expressed by financial regulators and other constituents, provided the IASB addresses the operational difficulties referred to below.

EFRAG's field-test highlights that the current proposals do not allow entities to leverage existing risk management and regulatory practices, and that not all necessary data is available; which may result in significant implementation costs. Constituents have identified a number of operational difficulties and uncertainties as to how the proposals should be applied. Therefore, EFRAG suggests the IASB reconsider whether the model could be implemented in such a way that entities are able to leverage their existing practices, and hence limit the costs and increase the reliability of their estimates. If such changes are not made, there should be a period of at least three years from finalisation of the standard to its effective date in order to allow appropriate time for systems development.

EFRAG understands that any impairment model that uses a single measurement approach under which lifetime expected credit losses are recognised at initial recognition – such as the model proposed by the FASB – will remove the need to reclassify financial assets from one stage to another. Nevertheless, in EFRAG's view, such an approach would provide less relevant information about the effects of changes in the credit quality subsequent to initial recognition, and would not result in an appropriate balance between the representation of the underlying economics and the cost of implementation.

EFRAG urges the Boards to try, where possible, to align their proposals. EFRAG strongly believes that the two fundamental objectives of depicting credit deterioration over the life of financial assets, and of presenting interest income that reflects faithfully the performance of the borrower should not be compromised, even for the sake of convergence. Therefore EFRAG does

not support any convergence towards proposals that fail to reflect credit deterioration appropriately.

Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)

On 4 July 2013, EFRAG issued an Invitation to Comment relating to the endorsement of the Amendments for use in the European Union and European Economic Area. It consulted its constituents both on its assessment of the Amendments against the technical criteria for the endorsement, and on its initial assessment of the costs and benefits that would arise from their implementation. Comments were requested by 11 July 2013. EFRAG alerted its constituents about the short comment period which was requested by the European Commission to enable a rapid endorsement, by issuing a news item on 28 June 2013.

The proposed amendments provide an exception to the requirement for the discontinuation of hedge accounting in IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* in circumstances when a hedging instrument is required to be novated to a central counterparty as a result of laws or regulations. The IASB is aware that these new laws or regulations could come into effect in some jurisdictions very soon. The Amendments apply retrospectively for annual periods beginning on or after 1 January 2014, with earlier application permitted.

At its July meeting EFRAG TEG discussed and approved the final endorsement advice and effects study report. EFRAG supports the adoption of the Amendments, and recommends their endorsement. EFRAG's recommendation is explained in the letter to the European Commission, and the accompanying Basis for Conclusions and the Effects Study Report on the costs and benefits of implementing the Amendments.

IASB Exposure Draft Insurance Contracts

At its meetings on 4 July and 15-17 July, EFRAG TEG discussed EFRAG's draft comment letter in response to the Exposure Draft. EFRAG TEG members agree on the content of the letter, but it will be subject to final approval in a conference call on 30 July.

EFRAG TEG members welcomed the changes made in the revised proposals and especially appreciated the efforts made by the IASB to address the accounting mismatch issue, and to distinguish short-term volatility from the long-term performance of an insurer. However, based on the findings of EFRAG's public consultation on long-term investing activities business models, EFRAG will request an extension of the scope of the use of other comprehensive income to a broader range of assets.

Overall, EFRAG TEG members agree with the revised proposals relating to adjusting the contractual service margin and the retrospective application of the future standard.

In relation to the measurement and presentation exception for contracts that require the entity to hold the underlying items and specify a link to the returns on those items, EFRAG TEG members expressed concerns that it would apply to limited types of contracts, leading to contracts with similar economic features being treated differently.

Jointly with European National Standard Setters and the IASB, EFRAG is organising field-test activities from the insurance and the reinsurance industry.

In this regard, EFRAG's response on the revised proposals to present insurance contract revenue in profit or loss will be subject to the results of the field-test.

IASB Project *Accounting for Macro Hedging*

At its July meeting EFRAG TEG received an educational session on the project from Commerzbank.

The topics covered were the current hedge accounting approach, the objectives with relation to Asset-Liability Management and methodology characteristics, as well as macro hedge accounting challenges to be addressed in the project.

No decisions were taken at the meeting.

IASB Exposure Draft *Defined Benefit Pension Plans: Employee Contributions (Proposed Amendments to IAS 19)*

At its July meeting, EFRAG TEG reflected on the comments received from constituents on its draft comment letter, and approved the final comment letter on the amendments that proposes narrow scope amendments to IAS 19 *Employee Benefits*.

In its final comment letter EFRAG agrees with the IASB's proposals on the basis that they provide relief to preparers on accounting for contributions from employees or third parties set out in the formal terms of a defined benefit plan. EFRAG also supports the IASB's proposal to address the existing inconsistency in IAS 19 (2011) in relation to the attribution of these contributions, as this would reduce potential divergence in practice.

Additionally, EFRAG suggests that the IASB ensure that the wording of the proposed amendments does not lead to confusion and uncertainties in their practical application. EFRAG also recommends that the IASB provide application guidance to illustrate the calculations required by IAS 19 (2011) when the practical expedient does not apply.

IFRIC Interpretation 21 *Levies*

At its July meeting EFRAG discussed and approved a draft endorsement advice on IFRIC 21 *Levies*, an IFRIC Interpretation on the accounting for levies imposed by government.

IFRIC 21 clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy.

EFRAG's initial assessment is that the Interpretation satisfies the technical criteria for EU endorsement. Consequently, EFRAG tentatively supports the adoption of the Interpretation and recommends its endorsement. Two EFRAG TEG members dissented from recommending the endorsement of IFRIC 21.

Comments on EFRAG's initial assessments are invited by 2 September 2013.

IASB Exposure Draft *Agriculture: Bearer Plants (Proposed amendments to IAS 16 and IAS 40)*

At its July 2013 meeting, EFRAG TEG approved a draft comment letter in response to the Exposure Draft. In the draft comment letter, EFRAG agrees that bearer plants should be accounted for under the cost or revaluation models of IAS 16 *Property, Plant and Equipment*. However EFRAG also believes that a broader scope could improve the reliability of financial reporting relating to agricultural activities. EFRAG thinks that IASB should reconsider the scope of the amendment, and EFRAG plans to assess difficulties in application of a broader scope. EFRAG also believes that clarification of certain requirements would assist in effectively applying IAS 16 to bearer plants.

IASB Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*

At its July meeting, EFRAG TEG considered three Bulletins on accountability, performance reporting and measurement.

EFRAG TEG also considered the discussion paper on the Conceptual Framework issued by the IASB. EFRAG TEG indicated some support for the idea expressed in the discussion paper that the purpose of the Conceptual Framework is to assist the IASB by identifying principles that the IASB can use consistently when developing and revising IFRS. EFRAG TEG members also thought that, in rare cases, and in order to meet the overall objective of financial reporting, the IASB should be permitted to issue a new or revised IFRS that conflicts with aspects of the Conceptual Framework. If this happens the IASB should, however, describe the departure from the Conceptual Framework, and the reasons for it. EFRAG TEG considered whether, as part of issuing the revised Conceptual Framework, the IASB should review all existing standards, identify any conflicts with the revised Conceptual Framework and justify or remove these conflicts.

EFRAG TEG saw some merits in the proposed definitions suggested in the discussion paper of an asset, a liability, an economic resource; and control. It was, however, noted that the new definitions could, depending on how the current definitions were interpreted, result in more assets being identified.

EFRAG TEG members had different views on recognition criteria. Some supported the view included in the IASB discussion paper that all assets and liabilities should be recognised except if the IASB, considering relevance and faithful representation, would decide on a standards level that such assets and liabilities should not be recognised. Others favoured recognition criteria related to the probability of inflows or outflows, and the degree of certainty by which these probabilities could be determined.

EFRAG TEG also had discussions on how to account for equity and how to distinguish equity from liabilities, on what other comprehensive income should consist of and on recycling of value changes originally presented in other comprehensive income.

EFRAG Public Consultation *Is there a need for specific financial reporting for long-term investing activities business models?*

At its July meeting, EFRAG TEG discussed the feedback received from the consultation by comment letters, as well as the feedback from the roundtable held on 8 July.

EFRAG TEG members agreed to have a supplementary letter to the IASB prepared, and then to discuss an EFRAG letter to the European Commission in relation to accounting issues raised in the long-term investing Green Paper.

EFRAG/ANC/FRC Proactive Project *The Role of the Business Model in Financial Reporting*

At its July meeting, EFRAG TEG tentatively approved a Research Paper on the role of the business model in financial statements. Before being issued, the Research Paper requires the approval of the ANC and FRC as partners in the proactive project.

The content of the Research Paper was used as the basis to develop and further support a recently issued Bulletin *The Role of the Business Model in Financial Reporting*. The Bulletin was one of a series of papers developed for the debate on the IFRS Conceptual Framework in partnership with the National Standard Setters from France, Germany, Italy and the United Kingdom.

EFRAG/OIC/ICAC/DASB Proactive Project *Separate Financial Statements*

At its July meeting, EFRAG TEG received a presentation on the results of outreach activities, which have been performed to identify how separate financial statements are used in Europe and the financial reporting issues that may have arisen. EFRAG TEG discussed how such results should be included in the future Discussion Paper, and how to account for transaction costs related to investments in subsidiaries, joint ventures and associates.