

Summary of EFRAG meetings held in November - December 2010

On 17 November and 2 December 2010, EFRAG held meetings by public conference call to discuss:

- the IASB's Request for Views on *Effective Dates and Transition Methods*
- IFRS Interpretations Committee Draft IFRIC Interpretation *Stripping Costs in the Production Phase of a Surface Mine*
- IASB Exposure Draft *Severe Hyperinflation (Proposed amendments to IFRS 1)*
- EFRAG project *Hybrid Financial Instruments*
- IASB Exposure Draft *Fair Value Option for Financial Liabilities*.

On 7 December 2010, EFRAG met with the European National Standard Setters in EFRAG's Consultative Forum of Standard Setters (CFSS) to discuss:

- EFRAG's activities on *Assessing the Effect of Proposed Accounting Standards Before they are Finalised*
- IASB project *Financial Instruments (replacement of IAS 39)*
- IFRS Interpretations Committee - *Review of Operational Efficiency and Effectiveness*.

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

- IASB Exposure Draft *Insurance Contracts*
- IASB Exposure Draft *Leases*
- IASB Amendments to IFRS 7 *Disclosures – Transfers of Financial Assets*
- IASB project *Hedge Accounting*
- EFRAG Proactive project *Business Combinations under Common Control*
- EFRAG Proactive project *Financial Reporting for Corporate Income Taxes*
- EFRAG Proactive project *The Role of the Business Model in Financial Reporting*
- IASB Staff Draft of forthcoming IFRS *Fair Value Measurement*
- EFRAG Proactive project *Considering the Effects of Accounting Standards*.

Highlights

Endorsement advice

EFRAG invited comments on its draft endorsement advice and draft effects study report to the European Commission on the Amendments to IFRS 7 *Financial Instruments: Disclosures – Transfers of Financial Assets*. The comment deadline is 21 January 2011 (page 6). →

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

Comment letters to the IASB

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

- Exposure Draft *Leases*. The comment letter is supportive of the decision to develop an accounting model to replace the existing IAS 17 *Leases*. However, EFRAG does not believe that the proposals in the ED are effective in addressing the concerns about the complexity of lease accounting and comparability of information. Furthermore, EFRAG is not convinced that the IASB had done sufficient work to ensure that the proposals result in information that is relevant to users of financial statements. (page 5).
- Exposure Draft *Insurance Contracts*. The comment letter supports some proposals, in particular on measurement. However, it expresses significant concerns on a number of issues, relating to accounting mismatches, the performance of an insurer, the residual margin, financial statement presentation and transitional requirements (page 5).
- Exposure Draft *Severe Hyperinflation (Proposed amendments to IFRS 1)*. The comment letter acknowledges the IASB's responsiveness in addressing the accounting issues faced by entities emerging out of severe hyperinflation; however, it raises various concerns regarding the scope and application of the proposals (page 3).

EFRAG invited comments on its draft comment letter to the IASB on the Request for Views on *Effective Dates and Transition Methods*. The comment deadline is 21 January 2011 (page 2).

Comment letter to the IFRS Interpretations Committee

EFRAG finalised its comment letter to the IFRS Interpretations Committee on the Draft IFRIC Interpretation *Stripping Costs in the Production Phase of a Surface Mine*. The comment letter proposes that the Committee consider requiring application of the accounting model in IAS 16 to all forms of stripping costs, as the Draft Interpretation is unlikely to significantly reduce diversity in practice (page 3).

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

During its meeting held by public conference call on 17 November 2010, EFRAG finalised its draft comment letter to the IASB in response to the Request for Views on *Effective Dates and Transition Methods* (the Request for Views). In view of the 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 constituents' views on whether and how to sequence effective dates in order to reduce the burden on interested parties.

The draft comment letter suggests distinguishing between two groups of standards as follows:

- Group 1 – single effective date of 1 January 2015 at the earliest. This group includes the standards resulting from the projects on *Revenue from Contracts with Customers*, *Leases*, *Insurance Contracts*, *Financial Instruments* (IFRS 9) and *Fair Value Measurement*.
- Group 2 – effective dates could be considered on a case-by-case basis and early adoption should be permitted. This group includes the standards resulting from the projects on *Post-employment Benefits: Defined Benefit Plans*, *Presentation of Items of Other Comprehensive Income*, *Consolidation* and *Joint Arrangements*.

The draft comment letter also suggests that different rules could be permitted for first-time adopters for pragmatic reasons. The draft comment letter is available on EFRAG's website. The comment deadline is 21 January 2011.

IFRS Interpretations Committee Draft IFRIC Interpretation *Stripping Costs in the Production Phase of a Surface Mine*

During its meeting held by public conference call on 2 December 2010, EFRAG finalised its comment letter to the IFRS Interpretations Committee in response to the Draft IFRIC Interpretation *Stripping Costs in the Production Phase of a Surface Mine* (the Draft Interpretation).

The Draft Interpretation clarifies that costs related to a stripping campaign meet the Framework definition of an asset. A stripping campaign is defined as a “systematic process undertaken to gain access to a specified section of the ore.” In other words, it relates to a process of removing waste ore in order to gain access to a designated section of a larger identified ore body.

EFRAG supports the Interpretations Committee in its efforts to address diversity in practice. However, EFRAG does not believe that the Draft Interpretation significantly reduces diversity in accounting for stripping costs. EFRAG believes that the Committee should consider requiring application of the accounting model in IAS 16 *Property, Plant and Equipment* to all forms of stripping costs. This would avoid introducing unnecessary complexity in IFRS.

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

During its meeting held by public conference call on 2 December 2010, EFRAG finalised its comment letter to the IASB in response to the 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 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.

EFRAG project *Hybrid Financial Instruments*

The EFRAG members received an update on the project status and timeline. EFRAG did not make any decisions at this meeting. EFRAG is planning to discuss this project at its January 2011 meeting.

IASB Exposure Draft *Fair Value Option for Financial Liabilities*

In November 2010, the IASB finalised the classification and measurement phase of the IAS 39 replacement project, when it issued the financial liabilities section of IFRS 9. The publication is the result of the re-deliberations of the Exposure Draft *Fair Value Option for Financial Liabilities* issued in May 2010. In its response to the ED, EFRAG noted that the proposals were an improvement compared to IAS 39 and that the IASB should consider amending the latter standard. This would not only result in a better standard, but would also improve the comparability between early adopters of IFRS 9 and those who still apply IAS 39, as all financial liabilities would be measured the same way, either under IFRS 9 or IAS 39.

On the re-issuance of IFRS 9 *Financial Instruments* (Recognition and Measurement of Financial Liabilities) the IASB published a feedback statement to explain that amending IAS 39 would undermine comparability. →

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At its conference call held on 2 December 2010, EFRAG considered whether to respond to the feedback statement. EFRAG decided to address this issue in its next joint meeting with the IASB in Q1 2011.

EFRAG's activities on Assessing the Effect of Proposed Accounting Standards Before They are Finalised

CFSS members discussed what, if anything, EFRAG should do, once it had issued its final comment to the IASB on a particular set of proposals. Typically, once EFRAG issues its comment letter, its activities are generally limited to following the IASB re-deliberations of the underlying proposals, until it reaches the endorsement process. However, the IASB is currently in the process of developing some key changes to the existing standards that would, in one way or another, impact virtually all industries across Europe. One of the key concerns raised by constituents in Europe was the need for field tests on the impact of the new accounting models being developed by the IASB.

EFRAG staff presented a paper proposing a short-term solution to the problem and ways in which EFRAG could assist the IASB in addressing concerns raised by European constituents on the IASB's 'priority' projects. It also suggested focusing on a longer-term solution and working closely with the IASB to address operational concerns raised by constituents. CFSS members shared EFRAG's concern about remaining silent once it had issued its final comment letter, particularly when EFRAG and European constituents expressed significant concerns on the proposals. No decisions were taken.

IASB project Financial Instruments (replacement of IAS 39)

EFRAG staff provided CFSS members with an update on all active IASB projects related to accounting for financial instruments. There was no debate on this subject and no decisions were taken.

IFRS Interpretations Committee - Review of Operational Efficiency and Effectiveness

The IFRS Foundation 'Trustees' Due Process Oversight Committee is carrying out a review of the Interpretations Committee (the Committee), formerly known as IFRIC, in order to assess its effectiveness. The review is being conducted by means of a questionnaire.

CFSS members considered a draft letter from EFRAG's Supervisory Board addressed to the Trustees of the IFRS Foundation, in response to a request for comments on the effectiveness of the Committee's objectives and to offer suggestions to improve the Committee's operations. The draft letter expresses some significant concerns, particularly relating to:

- the quality of the assessment of some of the issues submitted to the Committee,
- some interpretations being based on the tentative IASB decisions (e.g., IFRIC 15 *Agreements for the Construction of Real Estate*);
- the wording for agenda rejections being drafted as interpretations themselves; and
- the 30-day comment period for draft agenda decisions, which may not always be sufficient to allow constituents to appropriately analyse the issues, respect their own due process and respond to the Committee in a timely manner.

CFSS members generally agreed with the direction of the draft letter and the key messages directed at the Trustees, while providing supplementary input.

The draft letter will shortly be available on EFRAG's website. The comment deadline is 31 January 2011.

IASB Exposure Draft *Insurance Contracts*

EFRAG finalised its comment letter to the IASB in response to the Exposure Draft *Insurance Contracts* (the ED). The comment letter is supportive of some proposals subject to addressing concerns about performance reporting issues. These proposals include the required measurement based on fulfilment cash flows and a building block approach that includes, separately, the recognition of a risk adjustment and a residual margin. It also supports the IASB's decision to include incremental acquisition costs in the fulfilment cash flows. However, the letter expresses a number of significant concerns, especially in the following areas: accounting mismatches resulting from the interaction of the proposals in the ED and other standards (e.g. IFRS 9 *Financial Instruments* and IAS 16 *Property, Plant and Equipment*); the approach to performance reporting by an insurer, which in EFRAG's view requires further development; treatment of the residual margin; the summarised margin presentation in the statement of comprehensive income; and the proposed transitional requirements. The comment letter also urges the IASB to carefully consider the results of field-testing performed on the ED and share the results with constituents.

In finalising the comment letter, EFRAG considered comments received from European constituents in response to the EFRAG's draft comment letter. The constituents generally shared EFRAG's concerns in respect of accounting mismatches resulting from the interaction with the requirements of IFRS 9 and its effect on the presentation of the performance of the insurer. They suggested a variety of different possible solutions to this concern. EFRAG will assess these different possible solutions in the January 2011 TEG meeting. Constituents also shared the concerns regarding the summarised margin presentation in the statement of comprehensive income. EFRAG is discussing alternative approaches to presentation that combine volume and margins information for life and non-life contracts, the results of which will be communicated to the IASB in due course.

EFRAG also considered feedback from European constituents on the treatment of financial guarantees in finalising its comment letter on the ED. Based on the responses received and taking into account that the current option in IAS 39 *Financial Instruments: Recognition and Measurement* has worked well in practice, EFRAG decided to recommend that the IASB retain this option.

IASB Exposure Draft *Leases*

EFRAG finalised its comment letter to the IASB in response to the Exposure Draft *Leases* (the ED). The comment letter is supportive of the decision to develop an accounting model to replace the existing IAS 17 *Leases*, provided that the proposals offer an effective improvement over the existing requirements. However, EFRAG does not believe that the proposals in the ED are effective in addressing the concerns about the complexity of lease accounting and comparability of information. Furthermore, EFRAG is not convinced that the proposals result in information that is relevant to users of financial statements.

In finalising the comment letter to the IASB, EFRAG considered comments received from the European constituents in response to EFRAG's draft comment letter. Based on the feedback received, the comment letter was amended to:

- expand the comments on the boundaries between leases and service arrangements and propose additional indicators to identify leases;
- support that the partial derecognition model for lessors is amended to require remeasurement of the residual asset so as to depict the return on the whole lease investment;
- confirm that EFRAG prefers separate recognition and measurement of options to extend and specify that, if they are to be included, EFRAG would support the inclusion of those payments that are virtually certain, as in IAS 17; and →

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- support a full retrospective approach in accordance with the general requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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* (the Amendment). The Amendment aims to help users of financial statements better evaluate the risk exposures relating to transfers of financial assets and the effects of those risks on an entity's financial position. Its objective is to promote transparency in the reporting of transfer transactions, particularly those that involve securitisation of financial assets.

EFRAG completed its initial assessment of the Amendment against the EU endorsement criteria and completed an initial study of its costs and benefits. EFRAG's initial assessment is that the Amendment meets the criteria for endorsement in the EU and the benefits that are expected to arise are likely to exceed the costs of implementation. EFRAG invited comments on its draft endorsement advice and a draft effects study report, which are both available on EFRAG's website. The comment deadline is 21 January 2011.

IASB project *Hedge Accounting*

EFRAG members continued discussing the developments of the IASB project *Hedge Accounting*, focusing on the IASB's tentative decisions in respect of the hedge accounting for individual items and closed portfolios.

On 9 December 2010, the IASB published the Exposure Draft *Hedge Accounting* (the ED). The proposals in the ED are intended to form a comprehensive review of the requirements for the general hedge accounting model. The IASB commenced discussions on the requirements for portfolio hedge accounting at its November 2010 meeting.

EFRAG did not make any decisions at this meeting and is planning to discuss its draft comment letter on the ED at its January 2011 meeting.

EFRAG Proactive project *Business Combinations under Common Control*

At the November 2010 TEG meeting, EFRAG discussed a model for the Business Combinations under Common Control (BCUCC) project that would trigger re-measurement, under certain conditions, in a BCUCC. Some EFRAG members expressed concern with the project approach. As a result, a revised model was developed for the December 2010 meeting, whereby the requirements of existing IFRSs should apply, prior to determining how the Framework and the reporting entity concept could assist in developing an approach to BCUCC.

The approach discussed at the meeting proposed that some BCUCC transactions needed to be analysed to assess whether it was appropriate to apply IFRS 3 *Business Combinations*. Where IFRS 3 is found not to be applicable, because of the nature of the transaction, other measurement approaches may be justified.

EFRAG generally supported the new approach, but thought that it would be useful to provide more examples in the discussion paper to show how the model would work. EFRAG members expressed mixed views on some of aspects of the model, for example, on whether there is sufficient clarity on how to apply the indicators that are intended to be used to decide whether a BCUCC has economic substance that is similar to a business combination with an unrelated party.

A refined paper reflecting the EFRAG discussion will be presented in a subsequent meeting.

EFRAG Proactive project *Financial Reporting for Corporate Income Taxes*

EFRAG members received an update on the progress made on the proactive project on accounting for income tax and were asked for views on the proposed direction.

EFRAG supported the proposed 'building block' approach to tax accounting, starting from assessing the tax effects of a transaction and building towards measuring a tax liability or asset by reference to the taxpayer. However, staff were directed to perform further work on some challenging issues that arise under IAS 12 *Income Taxes*, including measurement of deferred tax assets and liabilities, particularly the application of discounting.

EFRAG discussed whether the consultation process should be done in phases or via a single comprehensive discussion paper. There was also discussion on the topics that should form part of a phased approach, and on whether further work was required to understand the arguments for replacement of IAS 12. It was agreed that a phased approach would be adopted (subject to the views of the other sponsoring boards) commencing with analysis of the practical issues in the current application of IAS 12.

EFRAG Proactive project *The Role of the Business Model in Financial Reporting*

The business model notion has gained increasing prominence in financial reporting. With the introduction of IFRS 9 it has recently been introduced into standard setting. Standard setters, accounting bodies, preparers, users and academics have considered what role, if any, it should play in financial reporting. To date the views seem to be divided. In 2009, EFRAG's Planning and Resource Committee added a project on the EFRAG's proactive agenda, the objective of which is to investigate the possible role of the business model notion within financial reporting.

At its December 2010 meeting, EFRAG approved the project plan and the call for candidates for the advisory panel for this proactive project. The call for candidates is available on EFRAG's website. The application deadline is 28 January 2011.

IASB Staff Draft of forthcoming IFRS *Fair Value Measurement*

In August 2010, the IASB posted on its website the staff draft of the forthcoming IFRS *Fair Value Measurement*. On 5 November 2010, EFRAG wrote a letter to the IASB reiterating its concern that due process had not been followed, regarding whether non-financial assets and liabilities should be scoped in the final standard (see EFRAG's comment letter on Exposure Draft *Fair Value Measurement* dated 16 October 2009). EFRAG urged the IASB to reconsider the work it had done and the conclusions it had reached on the applicability of the guidance to non-financial items, and subject the results of that reconsideration, together with the accompanying reasoning, to public consultation and debate.

The IASB replied to EFRAG's letter. EFRAG considered the IASB's response, which referred to the due consultation process followed by the IASB on this project. No decisions on further steps were taken at the meeting.

EFRAG Proactive project *Considering the Effects of Accounting Standards*

EFRAG approved a discussion paper setting out the rationale for standards setters considering the effects of accounting standards over their life cycle from the agenda decision stage to post-implementation. Early drafts of the paper have also been discussed at the global National Standard Setters forum and at the IFRS Advisory Council, where the proposals in the paper were strongly supported by many participants. The UK Accounting Standards Board (ASB), the partner in the project, will discuss the paper at their forthcoming December 2010 meeting. It is expected that the paper will be published for comment early in January 2011.

Future meetings

The next meeting of EFRAG TEG will take place on 12-14 January 2011.

Conference call is scheduled for 4 January 2011.