

Summary of EFRAG meetings held in May - June 2010

On 17 May and 1 June 2010, EFRAG held meetings by public conference call to discuss:

- IASB Exposure Draft *Measurement of Liabilities in LAS 37*
- IASB project *Annual Improvements 2008-2010*
- IASB Exposure Draft *Defined Benefit Plans (Proposed amendments to LAS 19)*
- IASB Exposure Draft *Fair Value Option for Financial Liabilities*
- IASB Exposure Draft *Presentation of Items of Other Comprehensive Income*.

On 8 June 2010, EFRAG met with the European National Standard Setters in EFRAG's Consultative Forum of Standard Setters (CFSS) to discuss:

- IASB Discussion Paper *Extractive Activities*
- French Standard Setter (ANC) review project of IFRS 2 *Share-based Payment*
- IASB project *Revenue Recognition: Revenue from Contracts with Customers*
- IASB project *Financial Statements Presentation (replacement of LAS 1 and LAS 7)*.

On 8-11 June 2010, EFRAG held its monthly meeting and discussed:

- IASB project *Leases*
- IASB project *Consolidation*
- IASB project *Fair Value Measurement*
- IASB project *Insurance Contracts*
- IASB project *Revenue Recognition: Revenue from Contracts with Customers*
- IASB Exposure Draft *Financial Instruments: Amortised Cost and Impairment*
- IASB project *Financial Statements Presentation (replacement of LAS 1 and LAS 7)*
- EFRAG Pro-active project *Business Combinations under Common Control*
- FASB Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*.

Highlights

Endorsement advice

EFRAG invited comments on its draft endorsement advice to the European Commission on the *Improvements to IFRSs 2008-2010*. The comment deadline is 17 June 2010 (page 2).

Comment letters to the IASB

- EFRAG finalised its comment letter to the IASB on the Exposure Draft *Measurement of Liabilities in LAS 37*. The comment letter is not supportive of the proposals and raises significant concerns about the due process (page 2). →

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.

Highlights (continued)

Comment letters to the IASB (continued)

- EFRAG invited comments on its draft comment letter to the IASB on the Exposure Draft *Defined Benefit Plans (Proposed amendments to IAS 19)*. The draft comment letter supports the proposals as short-term improvements but emphasises that a deeper review is needed on fundamental issues related to both pensions and performance reporting. The comment deadline is 25 August 2010 (page 3).
- EFRAG invited comments on its draft comment letter to the IASB on the Exposure Draft *Fair Value Option for Financial Liabilities*. The draft comment letter agrees that fair value changes, due to changes in an entity's own credit risk from remeasurement of liabilities designated under the fair value option, should not impact profit or loss; however, EFRAG does not support the proposed two-step approach. The comment deadline is 6 July 2010 (page 3).
- EFRAG invited comments on its draft comment letter to the IASB on the Exposure Draft *Presentation of Items of Other Comprehensive Income*. The draft comment letter strongly objects to the IASB's initiative to remove the option of presenting performance in two statements, prior to a discussion on fundamental issues related to performance reporting. The comment deadline is 10 September 2010 (page 3).

IASB Exposure Draft *Measurement of Liabilities in IAS 37*

During its meeting held by public conference call on 17 May 2010, EFRAG finalised its comment letter in response to the IASB Exposure Draft *Measurement of Liabilities in IAS 37* (the ED). The comment letter is not supportive of the proposals in the ED. The major comments include the following:

- *Measurement objective* – EFRAG disagrees with the proposal as it believes that expected outflow to settle the liability provides the most useful information;
- *Value versus cost notion* – EFRAG believes that measurement should be based on cost, as opposed to the proposed value notion;
- *Expected value* – EFRAG expresses concern about the application of the expected value method to single liabilities;
- *Risk adjustment* – EFRAG does not support the proposal to change the existing IAS 37 to require the inclusion of a systematic adjustment for the risk in measuring liabilities in the scope of IAS 37;
- *Due process* – EFRAG believes that the full standard should be re-exposed; and
- *Removal of the “probability of outflows” recognition criterion* – EFRAG does not support the proposal to remove the probability of outflows recognition criterion in the absence of a proper debate on this aspect of the conceptual framework.

IASB project *Annual Improvements 2008-2010*

EFRAG completed its initial assessment of the *Improvements to IFRSs 2008-2010* against the EU endorsement criteria and completed an initial study of their cost and benefits. EFRAG's initial assessment is that the *Improvements to IFRSs 2008-2010* meet the criteria for endorsement in the EU and the benefits that are expected to arise are likely to exceed the cost of implementing the improvements. EFRAG invited comments on its draft endorsement advice and its draft effects study report, which are both available on EFRAG's website. The Invitation to Comment includes a specific question to constituents on whether they agree with EFRAG's preliminary assessment that users in year one will be subject to insignificant costs in relation to the IFRS 1 *First-time Adoption of IFRSs – Use of deemed cost for operations subject to rate regulation amendment*. The comment deadline is 17 June 2010.

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

EFRAG finalised its draft comment letter in response to the IASB Exposure Draft *Defined Benefit Plans (Proposed amendments to IAS 19)* (the ED). The draft comment letter supports the proposals in the ED as short-term improvements of employee benefit accounting, but emphasises that a deeper review is needed to bring significant improvement to the financial reporting of employee benefits and a proper debate should be held on fundamental issues related to both pensions and performance reporting. The draft comment letter notes that EFRAG's views should be read exclusively in the context of the ED and do not necessarily apply to other projects. The draft comment letter is available on EFRAG's website. The comment deadline is 25 August 2010.

IASB Exposure Draft *Fair Value Option for Financial Liabilities*

EFRAG finalised its draft comment letter in response to the IASB Exposure Draft *Fair Value Option for Financial Liabilities*. The draft comment letter is overall supportive of the proposal that fair value changes due to changes in an entity's own credit risk from remeasurement of liabilities, designated under the fair value option, should not impact profit or loss. EFRAG also accepts that such changes should be reported in other comprehensive income (OCI). However, EFRAG does not support the proposed two-step approach. EFRAG believes that the introduction of such a new presentational method in IFRS is not justified prior to a proper debate on fundamental issues related to performance reporting, such as (a) the notion of performance and the impact of business models on it, (b) the content of the performance statement(s) and (c) recycling.

The exposure draft only focuses on accounting for the impact of own credit risk on liabilities designated under the fair value option. However, EFRAG's draft comment letter solicits views of constituents on some overarching aspects of the new requirements for classification and measurement of financial instruments. The questions to constituents are set out in an appendix to the draft comment letter.

The draft comment letter is available on EFRAG's website. The comment deadline is 6 July 2010.

IASB Exposure Draft *Presentation of Items of Other Comprehensive Income*

During its meeting held by public conference call on 1 June 2010, EFRAG finalised its draft comment letter in response to the IASB Exposure Draft *Presentation of Items of Other Comprehensive Income* (the ED). The draft comment letter strongly objects to the IASB's initiative to remove the option of presenting performance in two statements prior to 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). It also observes that this proposal would not result in any change or improvement to current financial reporting. Therefore, the draft comment letter does not support the proposals.

The draft comment letter is overall supportive of the proposal to present separately 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). The draft comment letter also is overall supportive of the proposal to allocate income tax to separate groups of other comprehensive income (i.e., recyclable and non-recyclable). However, the draft comment letter suggests that it would be more efficient to finalise the disaggregation amendments as part of the Annual Improvements process without a separate re-exposure within the next Annual Improvements cycle.

The draft comment letter is available on EFRAG's website. The comment deadline is 10 September 2010.

At the CFSS meeting, the members shared their views on the IASB Discussion Paper *Extractive Activities* and EFRAG's response to it. In addition, members were updated on the following tentative decisions reached by the IFRS Interpretations Committee on accounting for stripping costs:

- *Scope of the forthcoming draft interpretation* – it is expected that the forthcoming draft interpretation will cover only surface mining, but that other extractive industries would be able to apply it by analogy. CFSS and EFRAG members tentatively raised concerns about the proposed scope.
- *Recognition* – it is expected that the draft interpretation would propose that stripping costs meet the asset recognition criteria as they are necessary to access an ore body, which the entity would not have access to otherwise.
- *Measurement* – the draft interpretation is expected to include a “specifically identified method” for measuring stripping costs. CFSS and EFRAG members tentatively raised concerns about the components of stripping costs.

These issues are expected to be discussed by the IFRS Interpretations Committee at its July 2010 meeting.

French Standard Setter (ANC) review project of IFRS 2 *Share-based Payment*

CFSS members received an update on the project conducted by the ANC to review IFRS 2. CFSS members discussed the measurement objective of share-based payment accounting and generally shared the view that the existing IFRS 2 does not provide a clear measurement objective. The members considered whether the share-based payment accounting should reflect the services received or the payments made by the entity. In addition, CFSS members discussed alternatives to the existing IFRS 2 treatment of cancellations and plan modifications.

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

At the CFSS meeting, members received an update on EFRAG's discussion of the expected proposals in the forthcoming IASB Exposure Draft *Revenue Recognition: Revenue from Contracts with Customers* (the ED). CFSS members generally expressed support for EFRAG's tentative decisions, which are detailed in the May 2010 issue of the EFRAG Update.

At its June 2010 meeting, EFRAG continued discussing the proposals in the forthcoming ED and focused on the following:

- *Allocating modification in contract price to performance obligations* – it is expected that the ED will require allocation of contract price modifications to different performance obligations under the contract, based on their initial stand-alone selling prices. EFRAG tentatively raised concerns that this proposal would be applied in all cases without considering the specific facts and circumstances. It also noted that a modification in price related directly to a specific unsatisfied performance obligation should not be allocated to other satisfied performance obligations.
- *Reflecting customer's credit risk in the measurement of revenue* – it is expected that the ED will require the customer's credit risk to be reflected in the initial measurement of revenue. EFRAG tentatively disagreed with this proposal as it believes that revenue should reflect the quantity and the prices of goods and services transferred to the customers. EFRAG tentatively decided that credit losses should not reduce revenue and should be presented separately.
- *Costs of securing a contract* – it is expected that the ED will not allow an entity to capitalise costs of securing a contract unless those costs would generate resources that would be used in satisfying performance obligations. EFRAG tentatively raised concerns about this proposal.

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

At the CFSS meeting, members received an update on EFRAG's discussion of the expected proposals in the forthcoming IASB Exposure Draft *Financial Statements Presentation* (the ED). CFSS members generally expressed support for EFRAG's tentative decisions, which are detailed in the May 2010 issue of the EFRAG Update.

At its June 2010 meeting, EFRAG continued discussing the proposals in the forthcoming ED and focused on the following:

- *Analysis of changes in balances of select assets and liabilities* – it is expected that the ED will include a list of factors, which management could consider in determining the items requiring a detailed analysis. EFRAG generally agreed that factors may be useful, but suggested that the standard should outline the general principle for selecting items requiring the analysis and that the list of factors be moved to the implementation guidance to maintain the right balance of rules and principles in a principle-based standard.
- *Remeasurements* – the ED is expected to require disclosure about remeasurements in a single note. EFRAG tentatively raised concerns about the usefulness of the disclosure, which could duplicate information required in the analysis of select assets and liabilities. It also questioned the proposed definition of a remeasurement. These issues will be discussed further with EFRAG's User Panel.
- *Cash flow requirements for financial services entities* – it is expected that the ED will require all entities, including financial services entities, to present operating cash flows using the direct method. However, the ED is expected to retain most of the current options in IAS 7 *Statement of Cash Flows* to present certain transactions on a net basis. However, deposit transactions between a financial service entity and its customers (e.g., crediting of interest to a customer account) would require presentation as cash flow transactions on a gross basis. EFRAG objects to the expected removal of the option to present operating cash flows using the indirect method. EFRAG noted that the statement of cash flows is of little value for the users of financial services and insurance entities' financial statements.
- *Definition of the financing section and the notion of "net debt"* – EFRAG continued discussing whether the financing section on the face of the primary statements should be defined based on the notion of net debt. However, no consensus was reached. EFRAG staff was directed to develop various examples showing how the financing section, particularly its bottom line, could be linked to the cash-flow statement and the reconciliation of net debt. This issue will be considered further at a future meeting.

IASB project *Leases*

EFRAG members received an update on the project developments since the publication of the Discussion Paper and the expected timetable for the Exposure Draft. The following issues were discussed:

- *Scope* – it is expected that the ED will apply only to leases of property, plant and equipment, and will include a number of scope exemptions for investment property carried at fair value, short-term leases and in-substance sales and purchases. EFRAG raised comments about the proposal to exclude intangible assets from the scope. In relation to the scope exemption for in-substance sales, EFRAG tentatively decided to urge the IASB to ensure consistency between the Leases and the Revenue Recognition projects. In addition, EFRAG noted that it was important to provide a clear distinction between lease and service agreements. →

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- *Lessee accounting* – it is expected that the ED will propose a right-of-use approach for lessee accounting. EFRAG noted that it was important to define when the lessee has the right to control the use of the asset.
- *Lessor accounting* – the IASB is currently considering two models for lessor accounting: the derecognition model and the performance obligation model. Under the derecognition model the lessor would derecognise the underlying asset (or part of the asset) and recognise a receivable for its right to receive rentals. Under the performance obligation model, the lessor would recognise a receivable and a liability for the performance obligation. The liability is released to the income statement as the performance obligation is satisfied by providing access to the underlying asset over the lease term. The decision about the proposed model has not been reached yet. EFRAG tentatively raised concerns that if the ED includes many alternatives, the proposals may fail to achieve simplification for lessor accounting. In addition, EFRAG did not favour the grossing up of assets and liabilities under the performance obligation model.
- *Rent extensions and contingent rents* – the IASB has tentatively decided that a lessor and a lessee would recognise rentals receivable or payable under the option to extend a lease agreement based on the longest lease term that is likely to occur. EFRAG tentatively agreed that options to extend a lease should not be ignored. However, members expressed mixed views on the proposed accounting. Some members supported the decision for practical reasons, whilst others raised concerns that it would lead to the recognition of amounts that do not meet the definition of assets and liabilities.

IASB project *Consolidation*

EFRAG discussed the developments on the IASB's Consolidation project and focused on the following:

- *Investment company exception* – the IASB has tentatively decided to require an investment company to account at fair value for controlled investees, rather than consolidate them, if certain criteria are met. The IASB also tentatively decided that the parent of an investment company should not retain on consolidation the fair value accounting applied by the investment company to those controlled investees. EFRAG is tentatively supportive of the investment company exception as long as it is “ring fenced” by clearly-defined criteria. EFRAG also believes that if fair value accounting is applied at the investment company level, then it should also apply at the parent company level.
- *Defining an agency relationship* – EFRAG discussed the tentative IASB decision on defining an agency relationship. EFRAG tentatively concluded that the proposed guidance could lead a fund manager to consolidate the underlying assets and liabilities of the fund that it manages. EFRAG did not believe that this would result in decision-useful information for users of the fund manager's financial statements.

IASB project *Fair Value Measurement*

EFRAG discussed the IASB tentative decision to publish a limited scope exposure draft of the measurement uncertainty analysis disclosure, including the effect of correlations. EFRAG members had mixed views in relation to this decision. EFRAG will further discuss the proposals once a consultation document is issued by the IASB.

EFRAG Pro-active project *Business Combinations under Common Control*

EFRAG received an update on the pro-active project Business Combinations under Common Control, which is conducted jointly by the Italian Standard Setter (OIC), EFRAG and ANC. EFRAG welcomed the work to date and plans to consider draft chapters of the discussion paper at its July 2010 meeting (time permitting).

IASB project *Insurance Contracts*

EFRAG discussed the following significant tentative decisions reached by the IASB in Phase II of its Insurance Contracts project:

- *Risk margin* – EFRAG is generally supportive of separately measuring a risk margin as part of an insurance liability. In EFRAG's view, this would result in useful information. In addition, EFRAG considered that the risk margin could be reliably measured taking into account current industry practice and the views of expert bodies. However, EFRAG tentatively agreed that the standard should not prescribe which methodologies could be used to measure the risk margin. Instead, the standard should specify principles for measuring the risk margin, providing an appropriate level of guidance and requiring transparent disclosure.
- *Changes in estimates* – in EFRAG's tentative view, the risk margin and the discounted estimate of cash flows should be re-measured at each reporting period with changes recognised in profit or loss.
- *Acquisition costs* – EFRAG is supportive of the tentative IASB's tentative decision to set-off direct incremental acquisition costs against the residual margin.

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

EFRAG considered comments received in response to its draft comment letter on the IASB's Exposure Draft *Financial Instruments: Amortised Cost and Impairment* (the ED). In this context, EFRAG also re-considered the responses it had received in relation to its outreach activities on the operational implications of the ED.

EFRAG redeliberated on the key messages in the comment letter and considered a number of significant amendments in the following areas:

- the operational costs of implementing the proposals versus the benefits;
- the objective of amortised cost measurement in the context of decoupling of estimates of credit losses from the effective interest rate methodology;
- treatment of changes in estimates in expected cash flows; and
- the nature and due process implications of guidance developed by the IASB's Expert Advisory Panel.

EFRAG plans to finalise its comment letter to the IASB at a public conference call scheduled for 23 June 2010.

FASB Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*

EFRAG discussed the FASB Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (the ED), which was issued for comments on 26 May 2010. EFRAG decided to prepare a comment letter that will address the key topics covered by the ED. EFRAG plans to issue its draft comment letter before the end of July 2010.

Future meetings

The next meeting of EFRAG TEG will take place on 13-16 July 2010.

Conference calls are scheduled for 23 June and 8 July 2010.