

October 2008

Summary of the EFRAG meetings in October 2008

On Wednesday 8 October 2008 EFRAG TEG (EFRAG) met with the European National Standard-Setters in EFRAG's Consultative Forum of Standard-Setters (CFSS) to discuss:

- IASB Project on *Revenue Recognition*
- IASB/FASB Phase B Discussion Paper *Financial Statement Presentation*

From Wednesday 8 to Friday 10 October 2008 EFRAG held its monthly meeting and discussed:

- IASB ED on an improved Conceptual Framework for Financial Reporting: *Objective and Qualitative Characteristics*.
- IASB Discussion Paper Preliminary Views on Amendments to IAS 19 *Employee Benefits*
- IASB ED Amendments to IFRS 1 *Additional Exemptions for First-time Adopters*
- IFRS 3R *Business Combinations* and IAS 27A *Consolidated and Separate Financial Statements*
- IASB Discussion Paper Preliminary Views on an improved Conceptual Framework for Financial Reporting: *The Reporting Entity*.
- IFRIC 15 *Agreements for the Construction of Real Estate*
- ED Improvements to IFRSs 2008
- PAAinE Project on the Asset Definition

In between its September and October meetings, EFRAG also held three meetings by public conference calls - on 16 and 26 September and 3 October – and discussed:

- IASB/FASB Discussion Paper *Financial Instruments with Characteristics of Equity*
- IASB Discussion Paper *Reducing Complexity in Reporting Financial Instruments*
- IASB ED *Simplifying Earnings per Share*
- Improvements to IFRSs 2008

On 14 October EFRAG held another public conference call meeting to discuss:

- Amendments to IAS 39 and IFRS 7: *Reclassification of Financial Instruments*

IASB project on Revenue Recognition

It is expected that the IASB and FASB will jointly issue a discussion paper on revenue recognition before the end of 2008. This discussion paper should lead to a new standard on revenue recognition before the end of 2011. The purpose of this session was to develop a better understanding of the main principles that are expected to be proposed in the paper.

The model for revenue recognition that is likely to be proposed in the paper focuses on contracts with customers. When an entity enters into a contract with a customer, the contract conveys rights to the entity to receive consideration from the customer and imposes obligations on the entity to transfer economic resources (goods and services) to the customer. These obligations are called performance obligations. The proposal is likely to be that revenue is recognised when the entity satisfies a performance obligation. This will be the case when an enforceable right or access to a good has been transferred to the customer or, when a service or access to a service has been provided. This means the proposal is that revenue is recognised for the output of economic resources to customers and not for the activity of the entity itself.

It is likely to be proposed that a performance obligation is identified whenever promised goods or services can be sold separately. This is expected to lead to more goods and services being identified than those explicitly promised in a contract. Hence, individual contracts are more likely to be unbundled into a greater number of performance obligations under the proposed model compared with current practice. EFRAG will be discussing this project in greater detail at its meeting in November.

IASB/FASB Phase B Discussion Paper Financial Statement Presentations

Denise Gomez Soto, IASB Project Manager in charge of the financial statement presentation project, gave a presentation on the IASB/FASB Discussion Paper on Phase B of the project. After her presentation, there was a discussion of the most important aspects of the upcoming Discussion Paper. The objective of the discussion was to provide some initial input for the EFRAG's comment letter on the Discussion Paper.

The Discussion Paper deals mainly with the following issues:

- implementation of the cohesive principle,
- the categorisation of balance sheet items into operating, investing, and financing, and the disaggregation into short-term and long-term within each category,
- (in addition to classifying income and expense items into the operating, investing, and financing categories), the disaggregation of income and expense items based on their function within those categories. Items should be further disaggregated by their nature within those functions to the extent that this will help users,
- the adoption of the direct method in statements of cash flows, and
- the introduction of a new reconciliation schedule, which would reconcile cash flows to comprehensive income. This reconciliation schedule disaggregates income into its cash, accrual, and disaggregates the remeasurement components (for example, fair value changes).

EFRAG will have a further discussion of the paper at its November meeting and the current intention is to issue a draft comment letter in December.

IASB ED on an improved conceptual Framework for Financial Reporting: *Objective and Qualitative Characteristics*

The objective of this session was to consider the comments received in response to EFRAG's draft comment letter on the IASB ED *An improved Conceptual Framework for Financial Reporting: Objective and Qualitative Characteristics*; and if possible to finalise the letter.

The main messages in EFRAG's draft letter were that, although the ED was an improvement over the discussion paper in many respects, some concerns remained. The main concerns related to the proposal:

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- to finalise the revised framework in stages, before all parts of the Framework are ready to be finalised. EFRAG argued that this was not fair to those trying to comment on the ED, and would also result inevitably in inconsistencies in the Framework until it has all been revised.
- that the entity perspective should be used for financial reporting. EFRAG argued that the issue needed to be debated comprehensively before a decision is taken, and the ED's analysis was not sufficient for this purpose.
- to replace 'reliability' with 'faithful representation'. EFRAG argued that, although there were clearly some misunderstandings as to what 'reliability' meant exactly, the solution was not to replace the notion with a notion that is not well understood either (faithful representation).

Generally respondents agreed with these messages and they have been retained in the final letter. EFRAG members decided to make a number of changes to the letter to reflect the detailed comments received. The revised letter was issued on 21 October and is available from EFRAG's website.

IASB Discussion Paper Preliminary Views on Amendments to IAS 19 Employee Benefits

At its October meeting, EFRAG considered the comments it received in response to its draft comment letter on the IASB Discussion Paper Preliminary Views on Amendments to IAS 19 Employee Benefits (DP). EFRAG agreed various minor changes in light of the comments received and approved the draft letter for issue. The final letter is now available from EFRAG's website.

IASB ED Amendments to IFRS 1 - Additional Exemptions for First-time Adopters

EFRAG discussed the ED on proposed amendments to IFRS 1. The proposed amendments address some issues that are thought likely to be problematical for jurisdictions adopting IFRSs in near future. In the ED it is proposed:

- that an entity that used full cost accounting under its previous GAAP shall be allowed to elect, at the date of transition to IFRSs, to measure exploration and evaluation assets at the amount determined under the entity's previous GAAP and to measure oil and gas assets in the development or production phases by allocating the amount determined under the entity's previous GAAP for those assets to the underlying assets pro rata using reserve volumes or reserve values as of that date;
- that an entity with operations subject to rate regulation shall be allowed to elect to use the carrying amount of items of property, plant and equipment held, or previously held, for use in such operations as their deemed cost at the date of transition to IFRSs if both retrospective restatement and using fair value as deemed cost are impracticable (as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*); and
- that, if a first-time adopter made the same determination under previous GAAP as that required by IFRIC 4 *Determining whether an Arrangement contains a Lease* but at a date other than that required by IFRIC 4, the first-time adopter need not reassess that determination when it adopts IFRSs.

The objective of the discussion was to develop comments for inclusion in a draft comment letter. EFRAG members were broadly supportive of the proposed amendments. However EFRAG had some concerns as to whether the oil and gas amendment was needed in the form proposed and decided to gather some additional information on the background to the proposed amendment so that the proposal can be discussed further. EFRAG will discuss the ED again at its November meeting before finalising its draft comment letter.

EFRAG reviewed the comment letters it had received in response to its Invitation to Comment on its initial assessment of the technical merits of IFRS 3R and IAS 27A against the endorsement criteria and the costs and benefits associated with implementing the new standards in the EU. It also considered the information it had gathered from consulting directly with a number of preparers and users about the costs and benefits associated with the implementation of the new standards. It noted that the findings from the various consultations were generally consistent with EFRAG's initial assessment of the likely effects of adopting the new standards. Having considered this material, EFRAG finalised its Effects Study Report of the new standards. EFRAG also concluded that the revised IFRS 3 and the amended IAS 27 met the technical criteria for endorsement by the EU and decided to issue Endorsement Advice Letter recommending their endorsement.

IASB Discussion paper Preliminary Views on an improved conceptual Framework for Financial Reporting: *The Reporting Entity*

EFRAG members considered the comments received in response to its draft comment letter on the IASB/FASB discussion paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity*. The purpose of the discussion was to finalise the comment letter.

The main messages in the draft letter were that:

- EFRAG agreed with the proposal that the Framework should contain a broad description of a reporting entity and it was also broadly happy with the broad description proposed. However, EFRAG did not agree with the proposal that control should be used as the basis for determining the composition of a group reporting entity. In EFRAG's view, both control and risks and rewards are needed.
- subject to that, EFRAG broadly agreed with the proposed definition of control and with the paper's comments that establishing whether control exists involves assessing all the existing facts and circumstances and that no single fact or circumstance will be evidence that one entity has control over another entity in all cases or will be a necessary condition for control to exist.
- EFRAG agrees that, if an entity that is a parent prepares a set of financial statements and accompanying notes that contain no information prepared on a consolidated basis, those financial statements will often not meet the proposed objective for general purpose financial reporting and will often need to be supplemented by a full set of consolidated financial statements for that objective to be met.

Generally commentators supported the views expressed in the draft comment letter although there were differing views on a number of detailed, but nevertheless important, issues. In the light of these comments, EFRAG decided to retain its main messages but also to make a number of changes to its letter. In particular, EFRAG decided to emphasise in its final letter the importance of ensuring that experiences from the global crisis in the financial markets are reflected fully in the revised Framework and that that Framework does not assume that there is financial stability. The revised letter was issued on 22 October and is available from EFRAG's website.

Improvements to IFRSs 2008

EFRAG has now discussed its draft comment letter on the IASB's ED of proposed Improvements to IFRSs 2008 at several meetings. EFRAG agrees with most of the proposed amendments but has some concerns. The purpose of the discussions at the public conference call meeting in early October and subsequent October monthly meeting was to finalise that draft letter. The draft has now been issued on EFRAG's website and comments are invited by 21 November 2008.

IFRIC 15 Agreements for the Construction of Real Estate

EFRAG discussed the comment letters it received in response to its Invitation to Comment on its initial assessments for endorsement of IFRIC 15 *Agreements for the Construction of Real Estate*.

Although the majority of the letters received agreed with EFRAG's initial assessment, two disagreed. Those two letters, which were from Swedish and Finnish preparers, argued that high year one and ongoing costs would be associated with the application of IFRIC 15. EFRAG had not received any indications from other jurisdictions that the application of IFRIC 15 would be costly. Therefore, EFRAG asked its staff to examine whether or not the increased costs that Swedish construction companies would face would mainly be due to the fact that IFRIC 15 would require a relatively big change to the current Swedish practice.

Subject to the outcome of the examination, EFRAG decided to recommend adoption of IFRIC 15.

PAAinE Project on the Asset Definition

The staff of the French standard-setter (the CNC) are, with the help of EFRAG staff, leading a PAAinE project that is looking at the new definition of 'an asset' that the IASB and FASB are developing. At its October meeting EFRAG looked at a draft of a paper reporting the results of that work, and made suggestions as to how it might be improved.

IASB/FASB Discussion Paper Financial Instruments with Characteristics of Liabilities

During the public conference call meeting on 16 September 2008 EFRAG finalised its comment letter on the Discussion Paper *Financial Instruments with Characteristics of Liabilities*. More details can be found under the related news item which was published on 19 September 2008 on EFRAG's website.

ED Simplifying Earnings per Share

EFRAG discussed a draft of its proposed comment letter on the IASB's ED *Simplifying Earnings per Share* during a public conference call meeting on 3 October 2008. EFRAG confirmed its position on the several issues discussed during its September meeting, but remained in two minds on the need for additional disclosures when introducing the so-called fair value method for financial instruments that can be settled in cash or shares, are classified as liabilities and are measured at fair value in their entirety with changes in fair value recognised in earnings. EFRAG therefore decided to ask a specific question on the issue in its draft letter.

EFRAG's draft comment letter is now available on EFRAG's website. Comments are invited by 1 December 2008.

IASB Discussion Paper Reducing Complexity in Reporting Financial Instruments

During the public conference call meeting on 26 September 2008 EFRAG finalised its comment letter on the Discussion Paper *Reducing Complexity in Reporting Financial Instruments*. More details can be found under the related news item, which was published 30 September 2008 on EFRAG's website

Amendment to IAS 39 and IFRS 7: Reclassification of Financial Instruments

On 13 October 2008 the IASB an amendment to IAS 39 that would permit the reclassification of some financial instruments, and an amendment to IFRS 7 to require disclosures about such reclassifications. The amendments were issued without any due process because the deterioration of the world's financial markets meant they were very urgently needed. On 14 October EFRAG held a public conference call meeting to consider the endorsement advice it should give on the amendments.

At that conference call, EFRAG heard that:

- the previous day the EFRAG Supervisory Board, as the oversight body of the EFRAG Technical Expert Group, had given EFRAG permission to deviate or suspend its normal due process when issuing endorsement advice on the amendments. The permission was given because the Supervisory Board had taken the view that, in the present financial crisis, all participants should be prepared to support and participate in enhancing stability.
- the European Commission had indicated to EFRAG that it would not be asking EFRAG to prepare an Effects Study Report on the amendments.

EFRAG considered the amendments and concluded that they met the criteria for endorsement in the EU and that therefore EFRAG should recommend their endorsement. EFRAG also decided that:

- it would avail itself of the EFRAG Supervisory board's permission to suspend its due process when issuing endorsement advice on the amendments; in other words, it would issue its endorsement advice without issuing it in draft form for comment beforehand; and
- it would not on this occasion prepare a Basis for conclusions to support its conclusion that it should recommend that the amendments be endorsed.

EFRAG's endorsement advice was issued on 14 October 2008. The amendments were endorsed on 15 October and are mandoty in the European Union from 17 October 2008.

Future meetings

The next meeting of EFRAG TEG will take place from 12 to 14 November 2008 at EFRAG's offices.