

Summary of EFRAG meetings held in June - July 2010

On 23 and 28 June and 8 July 2010, EFRAG held meetings by public conference call to discuss:

- IASB Exposure Draft *Financial Instruments: Amortised Cost and Impairment*
- IASB Exposure Draft *Conceptual Framework for Financial Reporting: The Reporting Entity*
- IASB Exposure Draft *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (Limited re-exposure of proposed disclosure)*.

On 13-16 July 2010, EFRAG held its monthly meeting and discussed:

- IASB project *Insurance Contracts*
- IASB Discussion Paper *Extractive Activities*
- EFRAG Proactive project *Business Combinations under Common Control*
- FASB Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*
- IASB Exposure Draft *Fair Value Option for Financial Liabilities*
- IASB project *Leases*
- IASB project *Annual Improvements 2008-2010*
- EFRAG Proactive project on cross-cutting changes to IFRS
- IASB Exposure Draft *Revenue Recognition: Revenue from Contracts with Customers*
- IFRS Interpretations Committee project *Accounting for Production Stripping Costs*
- EFRAG outreach effort to support IASB project *Financial Statement Presentation*.

Highlights

Endorsement advice

EFRAG discussed the comments from constituents and decided to finalise the endorsement advice to the European Commission on the *Improvements to IFRSs 2010* at a conference call scheduled for 23 July 2010 (page 6).

Comment letters to the IASB

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

- Exposure Draft *Financial Instruments: Amortised Cost and Impairment*. The comment letter is supportive of the “forward-looking” direction of the proposed approach, but includes significant concerns about some aspects of the measurement principles and practical implementation of the proposals (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)

- Exposure Draft *Conceptual Framework for Financial Reporting: The Reporting Entity*. The comment letter is broadly supportive of the proposed description of a reporting entity. However, EFRAG has concerns about the discussion of the definition of “control” that underpins the reporting entity concept (page 3).
- Exposure Draft *Fair Value Option for Financial Liabilities*. The 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 except for extremely rare circumstances where the fair value changes of financial assets are directly linked to an issuer’s own credit risk. However, EFRAG does not support the proposed two-step approach (page 5).
- Discussion Paper *Extractive Activities*. The comment letter is overall not supportive of the proposals and argues that the discussion paper had not adequately explained why a separate accounting model, different from that applied by, for example, pharmaceutical companies, was appropriate for these activities. However, some aspects of the proposals, including the historical cost measurement basis and disclosure objective, are supported (page 4).

EFRAG invited comments on its draft comment letter to the IASB on the Exposure Draft *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (Limited re-exposure of proposed disclosure)*. The draft comment letter is supportive of the IASB proposals. The comment deadline is 27 August 2010 (page 3).

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

During its meeting held by public conference calls on 23 and 28 June 2010, EFRAG finalised its comment letter in response to the IASB Exposure Draft *Financial Instruments: Amortised Cost and Impairment* (the ED). The major comments include the following:

- EFRAG supports the direction of the proposals in the ED that uses more forward-looking information about credit losses and aims at eliminating the delay in recognition of credit losses on financial assets.
- Conceptually, EFRAG is supportive of the measurement principles but has significant concerns about some aspects of those principles. These relate primarily to the estimation of the timing and amount of expected credit losses, the treatment of changes in estimates and treatment of financial assets, which will be extended or renewed.
- Operationally, most of the EFRAG’s constituents believed that, unless there was significant simplification, the cost of implementing the proposals in the ED would likely outweigh the benefits.
- EFRAG is currently not in a position to comment on the proposals of the Expert Advisory Panel. However, EFRAG considers that operational simplification is crucial to making the proposals workable and the comment letter urges the IASB to consider these developments carefully with a view to providing additional guidance and/or amendments to the ED’s proposals. Due process considerations are likely to lead to re-exposure.

IASB Exposure Draft *Conceptual Framework for Financial Reporting: The Reporting Entity*

During its meeting held by public conference calls on 8 July 2010, EFRAG finalised its comment letter in response to the IASB Exposure Draft *Conceptual Framework for Financial Reporting: The Reporting Entity* (the ED). The comment letter is broadly supportive of proposed description of a reporting entity, however includes significant concerns about the following:

- EFRAG believes that the notion of “control” should be discussed at a higher level than the chapter of the framework dealing with the reporting entity because it not only operates as a principle for the aggregation of entities but is also critical to issues of recognition and derecognition of an asset.
- EFRAG considers that the perspective, from which financial statements are presented, is critical for assessing how to satisfy the objective of financial reporting and resolving accounting policy issues. The discussion on the perspective for presentation of financial statements must be carried out in the context of the *Conceptual Framework* and include an in-depth analysis of the implications of the perspectives considered.
- EFRAG believes that the conceptual framework project should be given a higher priority and should not be finalised on a piecemeal basis but as a whole. EFRAG believes that except for the circumstances where an exception to the existing framework is fully justified, standard setting should not depart from the conceptual framework.

IASB Exposure Draft *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (Limited re-exposure of proposed disclosure)*

EFRAG finalised its draft comment letter in response to the IASB Exposure Draft *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (Limited re-exposure of proposed disclosure)* (the ED). The ED proposes to change the sensitivity disclosure of assets and liabilities measured at fair value within level 3 of the fair value hierarchy to focus on unobservable inputs and to consider the effect of correlation between inputs where relevant and significant.

The draft comment letter is supportive of the proposals. The draft comment letter is available on EFRAG’s website. The comment deadline is 27 August 2010.

IASB project *Insurance Contracts*

EFRAG members received an update on the project developments. EFRAG considered some of the significant tentative decisions the IASB has made as part of its Insurance Contracts project and discussed the following issues:

- *Level of aggregation* – EFRAG reconfirmed its previous view that diversification between portfolios should be considered to the extent that an insurer can benefit from diversification.
- *Re-measurement* – EFRAG disagrees with the IASB’s view that the residual profit margin should not be recalibrated for changes in estimates.
- *Financial Statement Presentation* – EFRAG does not support the summarised margin presentation because it does not show information about the business activity.
- *Discounting* – EFRAG raised concerns about the reliability of adding a liquidity premium. →

→

- *Transition* – It is expected that the ED will require that on transition to the new standard any difference with the previous value of the liability, whether positive or negative, to be taken to opening retained earnings. EFRAG tentatively disagrees with this proposal as it believes that showing the remaining profit from the existing portfolios in future periods may provide better information. EFRAG considered that some form of retrospective approach should be investigated.

IASB Discussion Paper *Extractive Activities*

EFRAG finalised its comment letter in response to the IASB Discussion Paper *Extractive Activities* (the DP). The comment letter argues that the discussion paper had not adequately explained why a separate accounting model, different from that applied by, for example, pharmaceutical companies, was appropriate for these activities. EFRAG suggested that the IASB first consider the application of current IFRS before industry-specific guidance was developed. EFRAG therefore did not support the proposals in the discussion paper other than:

- historical cost measurement being an appropriate measurement basis;
- the industry scope to the extent that it is applied to disclosure guidance; and
- the disclosure objectives and certain proposals to achieve those objectives.

In relation to the Publish What You Pay proposals EFRAG noted that, while some users of financial information may find the disclosures useful to assess the investment and reputational risks relating to an entity, it is not clear how investors and other capital market participants would use the information to assess the financial position and performance of an entity. EFRAG thinks the IASB should conduct the necessary research, for both extractive and other industries where this information may be relevant, to determine how this information would be used by investors and other capital market participants and whether the costs of preparation would not exceed its benefits. In EFRAG's view, these disclosures would be subject to the materiality requirements in the *Framework for the Preparation and Presentation of Financial Statements* and IAS 1 *Presentation of Financial Statements*.

EFRAG Proactive project *Business Combinations under Common Control*

EFRAG and the national standard setters of France (ANC) and Italy (OIC) jointly conduct a proactive project on Business Combinations under Common Control. During this meeting, EFRAG discussed three draft chapters of a forthcoming Proactive Discussion Paper on this project (the DP). The discussion focused on the following proposals:

- *Chapter one: Introduction.* The chapter outlines the current problem in the area of business combinations under common control, which are scoped out of IFRS 3 *Business Combinations*. Generally, entities have an accounting policy choice, which has created diversity in practice.
- *Chapter two: Scope of the Discussion Paper.* The chapter defines the boundaries of the DP. The draft suggests that in determining the scope, it is necessary to agree on whether the DP would address a) the accounting by transferee or by the transferor, or both; b) consolidated or separate financial statements, or both; and c) recognition and measurement issues. The draft chapter proposes that the focus should be on the transferee accounting in both the consolidated and separate financial statements, and that the DP should address measurement issues only. →

→

- *Chapter three: Defining the problem.* The chapter identifies the key characteristics of a business combination under common control and considers how these characteristics differ from a business combination. The draft chapter proposes that the dividing line between the two is based on the consideration as to whether the transactions are conducted on an arm's length basis.

EFRAG members were broadly supportive of the first three chapters and the direction of the DP focusing on the transferee accounting. As the project progresses, there may be consideration of the impact of the proposals on the transferor accounting.

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

EFRAG continued discussing 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 has tentatively agreed to develop its draft comment letter to the FASB, which will express broad support for the directions of the model proposed by the IASB for accounting for financial instruments. The draft comment letter will focus on the following issues:

- *Mixed measurement and business model:* The ED proposes that financial instruments be measured at fair value, regardless of the business model adopted by the entity in managing those financial instruments. EFRAG tentatively expressed concerns about this proposal and reaffirmed its view that classification and measurement of financial instruments should be either at amortised cost or fair value, depending on the characteristics of the financial instrument and the business model used by the entity in managing those financial instruments.
- *Impairment model:* The ED proposes that an entity should consider all available information relating to past events and existing conditions, but should assume that existing conditions would remain unchanged for the remaining life of the asset (i.e., without considering future events). EFRAG tentatively expressed concern about this proposal and reaffirmed its preference for the expected loss approach that uses all available credit-related information, including forecasts of future events and future economic conditions.

EFRAG has tentatively agreed to include recommendations on how the IASB model/proposals could be further improved to serve the basis of a high quality standard on accounting for financial instruments.

The draft comment letter will be finalised at a public conference call scheduled for 23 July 2010. In addition, EFRAG has invited analysts, investors and regulators to an outreach event dedicated to the accounting for financial instruments. The outreach event is scheduled for 15 September 2010.

IASB Exposure Draft Fair Value Option for Financial Liabilities

EFRAG finalised its comment letter in response to the IASB Exposure Draft *Fair Value Option for Financial Liabilities*. The 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, except for extremely rare circumstances where the fair value changes of financial assets are directly linked to an issuer's own credit risk.

→

→

Whilst EFRAG's initial preference was not to recognise changes in own credit risk at all, as expressed in the response to the IASB's Discussion Paper *Credit Risk in Liability Measurement* issued on 23 September 2009, EFRAG had been convinced that the introduction of a new, supplementary measurement attribute is not desirable. EFRAG therefore supported the proposal to recognise and report changes in own credit risk in other comprehensive income (OCI). This support was reluctantly expressed as EFRAG believes that a thorough debate on fundamental issues underlying performance reporting, including the role of OCI, is necessary. In this respect, EFRAG did not support the two-step approach to presentation proposed in the ED. In EFRAG's view, the introduction of such a new presentational method in IFRS is not justified, and would create potential confusion and complexity.

Finally, the comment letter expressed the view that the proposals in the ED represented an improvement to the current IAS 39 *Financial Instruments: Recognition and Measurement*, and urged the IASB to consider amending that standard correspondingly.

IASB project *Leases*

EFRAG discussed the forthcoming IASB Exposure Draft *Leases* (the ED). The discussion focused on the following key issues, which will form basis for the EFRAG's draft comment letter on the ED:

- *Scope* – It is expected that the forthcoming ED will exclude leases of intangible assets from its scope. EFRAG tentatively disagreed with this forthcoming proposal.
- *Lessee accounting* – The forthcoming ED is expected to propose the right-of-use model for lessees. EFRAG tentatively supported this model for lessee accounting, subject to a clear and operational distinction between leases and service agreements. In addition, some members expressed concern about the expected requirement for a lessee to treat all payments as lease payments if services are not separable.
- *Lessor accounting* – It is expected that the ED will propose a “hybrid” accounting model for lessors based on the two models considered by the IASB: the derecognition model and the performance obligation model. EFRAG tentatively raised concerns about the complexity of the expected proposal and expressed its preference for a single partial derecognition model. In addition, EFRAG reiterated the need to ensure consistency between the *Leases* project and the *Revenue Recognition* project.
- *Renewal options* – The ED is expected to include a proposal for a lessor and a lessee to 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 disagreed with the proposal. EFRAG expressed its tentative support for separate measurement of options to purchase, terminate and extend a lease.

IASB project *Annual Improvements 2008-2010*

EFRAG discussed the comments from constituents and decided to finalise the endorsement advice to the European Commission on the *Improvements to IFRSs 2010* at a public conference call scheduled for 23 July 2010.

EFRAG Proactive project on cross-cutting changes to IFRS

EFRAG discussed the proposal to issue an educational paper considering the extent of cross-cutting changes to IFRS. The paper would aim to explain to constituents some common trends in overall changes, which re-shape IFRS. Based on the preliminary discussion, EFRAG recommended that educational papers, in general, be considered in advance and in support of IASB's consultations rather than in potential support of the implementation phase. EFRAG made an overall positive assessment of the papers presented for the discussion and suggested that they would prove useful in a different context.

IASB Exposure Draft *Revenue Recognition: Revenue from Contracts with Customers*

EFRAG discussed the IASB Exposure Draft *Revenue Recognition: Revenue from Contracts with Customers* (the ED) with a view to developing its draft comment letter. EFRAG agreed to welcome the work carried out jointly by the IASB and FASB, however highlight the need for a thorough debate on fundamental issues underlying performance reporting, including the notion of performance, and the discussion about what revenue should depict to bring useful information to capital providers.

Consistent with its view on the IASB Discussion Paper Preliminary Views on *Revenue Recognition in Contracts with Customers*, issued in December 2008, EFRAG tentatively reaffirmed its preference for a revenue recognition model, which would represent a measure of activity carried out to fulfil a contract with a customer, subject to specific conditions being met. Therefore, EFRAG overall did not support the control model proposed in the ED.

The following key messages were agreed for the draft comment letter:

- EFRAG supports the proposed guidance on combining and segmenting contracts and contract modifications.
- EFRAG overall supports the proposed guidance for separating performance obligations. However, EFRAG believes that in considering whether a promised good or service is distinct, only the entity's *own* customary business practice should be considered rather than business practice of other entities.
- EFRAG believes that the definition of control should be developed at the conceptual framework level to ensure consistency across the standards. In addition, EFRAG has concerns about the application of the proposed control model to service contracts and about the usefulness of the indicators included in the ED for determining when control of a promised good or service has been transferred to a customer.
- EFRAG does not support the proposal to reflect the customer's credit risk in revenue.
- EFRAG believes that subsequent changes in the estimated transaction price should be allocated to different performance obligations based on facts and circumstances rather than in proportion to the standalone selling prices.
- EFRAG does not support the proposal to recognise a liability for an onerous performance obligation included in an overall profitable contract.

The draft comment letter on the ED will be finalised at a public conference call scheduled for 23 July 2010.

IFRS Interpretations Committee project *Accounting for Production Stripping Costs*

EFRAG received an update on the IFRS Interpretations Committee project *Accounting for Production Stripping Costs*. EFRAG did not reach any tentative conclusions and further research will be presented to the TEG at its September 2010 meeting.

EFRAG outreach effort to support IASB project *Financial Statement Presentation*

In July 2010, the IASB published a staff's draft of the Exposure Draft *Financial Statements Presentation* (the ED). EFRAG discussed how to best assist the IASB in assessing whether the proposals included in the staff's draft of the ED need to be revised prior to finalising the ED in the first quarter of 2011, and if so then to what extent.

To that purpose, EFRAG has agreed to organise outreach activities with European constituents and invite the IASB to participate. EFRAG intends to issue its first assessment of the proposals included in the staff's draft of the ED in September 2010. This document would highlight the areas of support and the areas of concerns, and would serve as a basis for the forthcoming dialogue with various stakeholders in Europe.

Future meetings

The next meeting of EFRAG TEG will take place on 8-10 September 2010.

Conference call is scheduled for 23 July 2010.