

February

Summary of EFRAG meetings held in February 2010

On 16, 18 and 19 February 2010, EFRAG held meetings by public conference call to discuss:

- IASB Exposure Draft *Measurement of Liabilities in IAS 37*
- IASB Exposure Draft *Financial Instruments: Amortised Cost and Impairment*
- IASB Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters*.

On 24 -26 February 2010, EFRAG held its monthly meeting and discussed:

- IASB Discussion Paper *Extractive Activities*
- IASB Exposure Draft *Management Commentary*
- IASB Exposure Draft *Measurement of Liabilities in IAS 37*
- IASB project *Hedge Accounting*
- IASB project *Insurance Contracts*
- IASB project *Financial Instruments*
- IASB project *Financial Liabilities*
- EFRAG Pro-active project *Financial Reporting for Corporate Income Taxes*
- EFRAG Pro-active project *Performance Reporting*
- EFRAG Pro-active project *Disclosure Framework*.

Highlights

Endorsement advice

EFRAG finalised its endorsement advice to the European Commission on the following:

- IASB Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters* (page 3).

Comment letters to the IASB

- EFRAG approved its final comment letter to the IASB on the Exposure Draft *Management Commentary*. The letter signalled overall support for the proposals in the ED but included some concerns (page 4).
- EFRAG invited comments on its draft comment letter to the IASB on the Exposure Draft *Measurement of Liabilities in IAS 37*. The draft comment letter is not supportive of the proposals. The comments deadline is 7 May 2010 (page 2).
- EFRAG invited comments on its draft comment letter to the IASB on the Exposure Draft *Financial Instruments: Amortised Cost and Impairment*. The draft comment letter is cautiously supportive of the proposals, but includes some significant concerns. The comments deadline is 1 June 2010 (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.

IASB Exposure Draft *Measurement of Liabilities in IAS 37*

During its meeting held by public conference call on 16 February 2010, EFRAG members finalised the draft comment letter in response to the IASB Exposure Draft *Measurement of Liabilities in IAS 37* (the ED). The draft comment letter is not supportive of the proposals in the ED and includes the following main messages:

- the measurement objective should be directed at providing decision-useful information to users of financial statements and that would best be achieved if measurement was based on the expected outflow of resources to settle the liability;
- the proposed model based on expected value, paired with the removal of the “probability of outflows” recognition criterion, is unlikely to provide decision-useful information. Additionally, the model may prove to be too complex to apply especially to single liabilities, where evidence of the distribution of outcomes will often be not available; and
- the “value to fulfil” the obligation should not include an adjustment for the risk that the actual outflows may differ from expected outflows, nor should a service obligation include a profit margin when the measurement is based on internal costs. This is consistent with the alternative views in the ED expressed by a number of IASB members.

In addition, EFRAG invited comments from constituents on the following issues, which were not included in the invitation to comment by the IASB:

- *Due process* – the full standard should have been re-exposed and not just the measurement requirements.
- *Removal of the probability of outflows recognition criterion* – the removal of the probability of outflows recognition criterion is not supported as it creates an inconsistency with the current IASB Framework.

The draft comment letter is available on EFRAG’s website. The original comments deadline was set as 19 March 2010, however subsequent to the IASB’s decision to extend the comment period for the ED, EFRAG also extended its comments deadline to 7 May 2010.

During its meeting on 24-26 February 2010, EFRAG held a conference call with Warren McGregor, IASB member, who provided some explanations in respect of proposals for situations involving uncertainty about the existence of an obligation. These proposals were included in the working draft of a standard, which would replace IAS 37 and which was published by the IASB on its website for information of constituents on 19 February 2010.

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

During its meeting held by public conference call on 18 February 2010, EFRAG members finalised the draft comment letter in response to the IASB Exposure Draft *Financial Instruments: Amortised Cost and Impairment* (the ED). The draft comment letter is cautiously supportive of the proposals in the ED, because they:

- eliminate the requirement for a trigger event, allowing entities to use a broader range of forward looking credit related information;
- allocate initially expected credit losses against interest revenue reflecting that a portion of contractual interest compensates for expected credit losses; and
- enhance transparency through presentation and disclosure.

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In addition, EFRAG's draft comment letter does highlight some significant concerns with the proposals in the ED including the following:

- application of the objective of amortised cost to short-term trade receivables;
- difficulty in estimating both the timing and amounts of future cash flows and the level of management judgment required; and
- due process around the output of the Expert Advisory Panel.

EFRAG also asked the IASB to clarify why changes in estimates are made in the period of the re-estimation and to address the treatment of financial assets that will be renewed or extended, such as credit card receivables and other forms of revolving credit.

The draft comment letter is available on EFRAG's website. The comments deadline is 1 June 2010. In the interim period EFRAG will undertake outreach activities with constituents to understand better the operational implications of the proposals.

IASB Amendment to IFRS 1 First-time Adoption of International Financial Reporting Standards Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters

In January 2010, EFRAG issued a draft endorsement advice and a draft Effect Study Report in respect of Amendment to IFRS 1, which was published by the IASB in January 2010. The Amendment to IFRS 1 provides first-time adopters of IFRS with a temporary exemption for comparative disclosures about liquidity risk and fair value measurement. This exemption is currently available to entities that already prepare financial statements in accordance with IFRS. Based on the comments received, at a conference call held on 19 February 2010, EFRAG agreed to issue to the European Commission both the positive endorsement advice and the Effect Study Report.

IASB Discussion Paper Extractive Activities

The IASB has a comprehensive research project underway on extractive activities together with a group of standard-setters from Australia, Canada, Norway and South Africa. The objective of the project is to develop an acceptable accounting approach for the issues that are unique to upstream extractive activities. The project is expected to result in an IFRS, which will replace IFRS 6 *Exploration for and Evaluation of Mineral Resources*. A Discussion Paper (DP) reflecting the findings and conclusions of the project team is expected in March 2010.

The DP is expected to cover the project scope and approach; definitions of mineral, oil and gas reserves and resources; requirements for asset recognition (including unit of account selection), measurement (including impairment) and disclosure. EFRAG members discussed the proposals expected to be included in the DP and expressed the following concerns:

- Reasons for developing a separate IFRS on extractive activities, other than disclosure purposes.
- The asset continuum approach expected to be included in the DP, which considers the exploration and evaluation costs as an enhancement of the legal right asset, does not receive large support. The proposals are primarily directed at intangible assets (such as legal rights and information) but the applicability of IAS 38 Intangible Assets is not considered in any detail.
- Unit of account guidance for wider application should be considered as part of the Framework revision.

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- Difficulties in assessing impairment identified in the DP are largely the result of the asset continuum approach, which EFRAG does not support. EFRAG would encourage the project team to develop guidance relating to the calculation of value in use in this industry.

EFRAG directed the staff to draft a comment letter, which will be considered at the March 2010 meeting.

IASB Exposure Draft *Management Commentary*

EFRAG finalised its comment letter in response to the IASB Exposure Draft *Management Commentary* (ED). The letter signalled overall support for the proposal in the ED, but included some concerns. The major comments include the following:

- Guidance on management commentary is supported; however it should not be given a high priority.
- There is a support for the high-level, principles-based approach, which would not include illustrative examples or detailed application guidance.
- The desirable qualitative characteristics of management commentary are not those, which are set out in the IASB Exposure Draft *Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information* issued in May 2008.
- IASB should not defer development of placement principles until *Phase E of the Conceptual Framework: Boundaries of Financial Reporting, and Presentation and Disclosure* is completed.
- It should be clarified that forward looking quantitative information should not be required and that management commentary type report, accompanying IFRS financial statements, could be prepared in accordance with local legislation or regulations that do not comply with the IASB's guidance on management commentary.

IASB project *Hedge Accounting*

EFRAG held educational sessions on the following topics:

- the impact of derivative accounting on risk management and risk disclosure and the resulting implications for financial analysis; and
- key principles of asset and liability management in a retail bank.

No decisions were reached at this meeting.

IASB project *Insurance Contracts*

IASB is currently redeliberating its proposals in respect of the insurance contracts project. One of the tentative IASB's decisions is to propose that acquisition costs in respect of insurance contracts would be recognised as expense as incurred. EFRAG Insurance Accounting Working Group asked members of the Technical Advisory Group (TEG) to provide their views on this treatment of acquisition costs. TEG continued its discussion of this issue but did not reach a consensus. The issue is expected to be redeliberated by the IASB at its March 2010 meeting.

IASB project *Financial Instruments*

EFRAG members were updated on the status of the IASB project *Financial Instruments*. No decisions were reached at this meeting.

IASB project *Financial Liabilities*

EFRAG considered the most recent tentative decisions made by the IASB with regard to classification and measurement of financial liabilities.

Financial liabilities are not included in the scope of IFRS 9 *Financial Instruments* issued in November 2009. The Exposure Draft *Financial Instruments: Classification and Measurement*, which was issued by the IASB in June 2009 and preceded IFRS 9 proposed to apply the same classification model to both financial assets and financial liabilities within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*. However, those proposals raised significant concerns that more liabilities would be accounted for at fair value, and therefore changes in entities' own credit risk would affect financial statements more frequently. The IASB decided to defer finalisation of classification and measurement requirements for financial liabilities to address these concerns.

In its subsequent redeliberations on this topic, the IASB decided that:

- Financial liabilities should be measured at amortised cost if they are not held for trading and do not have embedded derivative features that would require bifurcation under IAS 39.
- The bifurcation requirements in IAS 39 should be retained.
- The fair value option and the three eligibility conditions for its application in IAS 39 would be retained, however, entities would be required to recognise the total fair value change in profit or loss; and recognise the portion attributable to changes in own credit risk in other comprehensive income (OCI) (with an offsetting entry to profit or loss). Amounts recognised in OCI would never be recycled into profit or loss.

EFRAG will continue discussing tentative decisions at its subsequent meeting focusing on the asymmetry in classification and measurement requirements for financial assets and financial liabilities and on the proposals in respect of own credit risk for situations when entities decide to apply the fair value option.

EFRAG Pro-active project *Financial Reporting for Corporate Income Taxes*

EFRAG discussed the pro-active project *Financial Reporting for Corporate Income Taxes*, which is supported by EFRAG and being lead by the UK Accounting Standards Board and the German Accounting Standards Board. The objective of the project is to examine critically key aspects of accounting for corporate income taxes separately from the requirements in existing IAS 12 *Income Taxes*. The project aims to develop alternative proposals on the accounting for income taxes, so they can be communicated to the IASB and considered in the IASB's *Income Tax* project. The proposals are expected to be issued for public comment as a European Discussion Paper. EFRAG received an update on the status of the project and reviewed the material developed at this stage. The following was noted during the discussion:

- Some EFRAG members do not fully agree with the criticism in respect of IAS 12 and do not believe that a convincing case has been set out in the material discussed to demonstrate that the standard is fundamentally flawed.
- User needs and information requirements should be carefully analysed and considered in deciding how tax information can be improved.
- The paper should develop a robust debate in respect of the comprehensive allocation approach in the existing IAS 12 to explain how it works.

EFRAG will continue to consider the development of material that will be included in the European Discussion Paper.

EFRAG Pro-active project *Performance Reporting*

In March 2009 EFRAG issued for public comment *Performance Reporting: A European Discussion Paper* (PAAinE DP). This PAAinE DP followed an initial discussion paper issued in November 2006 *What (if anything) is wrong with the good old Income Statement?* The purpose of the PAAinE DP was to discuss some fundamental issues about the presentation of financial performance. The comment period for PAAinE DP closed on 31 December 2009. EFRAG received 16 comment letters, which are available on EFRAG's web site. At this meeting, EFRAG reviewed a draft summary of comments, which will be forwarded for review to the national standard-setters participating in this pro-active project, and then will be published on the websites of the parties involved. The comments received on the PAAinE DP will be considered in developing views when responding to the IASB due process documents related to the Financial Statements Presentation project. In addition, EFRAG will consider what further work it will do in this area as the IASB develops its proposals in its project. If any further work is considered necessary, then EFRAG will present its proposal to the pro-active activities Planning and Resource Committee.

EFRAG Pro-active project *Disclosure Framework*

EFRAG members continued the discussion in respect of the pro-active project *Disclosure Framework*. The discussion focused on the purpose of disclosures and the needs of users. EFRAG agreed that it was important to apply materiality to disclosures and that users require standardisation of information to achieve comparability of different entities. Some members indicated that it could be useful to develop disclosures based on an industry approach. As part of the arrangements for the project, a pan-European advisory panel is being set up to support the work, and EFRAG is now seeking nominations for membership of that panel. Further information is available on EFRAG's website.

Future meetings

The next meeting of EFRAG TEG will take place on 24 – 26 March 2010.