

April 2011

Summary of EFRAG meeting held in April 2011

From 6 to 8 April 2011, EFRAG held its monthly meeting and discussed the following:

- IASB supplementary document to Exposure Draft *Financial Instruments: Impairment*
- IASB Exposure Draft *Revenue from Contracts with Customers*
- IASB Exposure Draft *Leases*
- IASB Exposure Draft *Insurance Contracts*
- EFRAG Proactive project *The Role of the Business Model in Financial Reporting*
- EFRAG Proactive project *Business Combinations under Common Control*.

Highlights

Comment letters to the IASB

EFRAG finalised its comment letter to the IASB in response to the supplementary document to the Exposure Draft *Financial Instruments: Impairment*.

The comment letter welcomes the IASB's and the FASB's efforts in developing a common approach to accounting for the impairment of financial assets. It also supports the approach based on decoupling of interest income and credit losses. However, EFRAG does not support the proposals in relation to the "floor", and urges the IASB to clarify the objectives of the revised impairment model and to field test the proposals prior to finalising the standard.

*IASB supplementary document to Exposure Draft **Financial Instruments: Impairment***

EFRAG finalised its comment letter to the IASB in response to the supplementary document to Exposure Draft *Financial Instruments: Impairment* (the Supplementary Document). The proposals in the Supplementary Document are part of the IASB's project to revise the requirements in IFRSs for accounting for financial instruments. After the re-deliberations are finalised, the proposals in the Supplementary Document will be combined with the original proposals included in the Exposure Draft *Financial Instruments: Amortised Cost and Impairment*, which was issued in November 2009.

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In its final letter, EFRAG welcomes the IASB's efforts to find operational solutions for the difficulties identified in respect of the model exposed in the November 2009 proposals. EFRAG also welcomes the IASB's and the FASB's efforts to develop a common approach to accounting for the impairment of financial assets. The key comments include the following:

- EFRAG supports the development of an approach based on the separate allocation (decoupling) of interest income and expected credit losses. We believe that the decoupling of interest income and credit losses should be applied consistently to all financial assets measured at amortised cost.
- The model proposed in the Supplementary Document has been designed primarily for the loan portfolios of lending businesses, and we believe that the IASB should further develop the guidance and the model to make it more suitable to non-lending businesses, closed portfolios and individual items (e.g., listed bonds).
- The IASB has made significant changes to the November 2009 impairment model, and therefore EFRAG believes that the IASB should clarify the objectives of the model. In particular, the IASB should be more explicit as to the extent that the proposals represent a revenue recognition and/or impairment model. Furthermore, EFRAG believes that the IASB should clarify that all incurred losses should be provided for in full.
- EFRAG believes that an impairment model should reflect the link between the pricing of the asset and the expected credit losses. EFRAG disagrees with the proposals to set a floor. Instead, an entity should be required to accelerate the build-up of the allowance balance if it expects losses to materialise in the near future.
- Reflecting input collected during the comment period, EFRAG recommends the IASB to conduct field-testing, prior to issuing the final standard, to confirm that the guidance is robust, the model is operational and overcomes the weaknesses of IAS 39 *Financial Instruments: Recognition and Measurement*. Furthermore, EFRAG urges the IASB to consider the proposals in the Supplementary Document in the context of the existing disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*.

IASB Exposure Draft *Revenue from Contracts with Customers*

EFRAG discussed the latest tentative decisions, which the IASB made in relation to measurement of the transaction price in its re-deliberations of the proposals included in the Exposure Draft *Revenue from Contract with Customers* (the ED). The following issues were considered:

- *Collectability*: the ED proposed adjusting the amount of promised consideration for the customer's credit risk. At its March 2011 meeting, the IASB tentatively decided that a customer's credit risk should not affect the revenue line, but be reported as a separate line item adjacent to revenue. EFRAG tentatively supported this approach, but questioned whether the final standard should prescribe a particular placement of the separate line in the income statement and, if so, where it should be reported.
- *Time value of money*: the ED proposed adjusting the amount of promised consideration for the time value of money, if the effect was material. At its March 2011 meeting, the IASB tentatively decided to specify in the final standard various factors for determining whether a contract has a significant financing component. In addition, the IASB tentatively decided that, as a practical expedient, contracts with a period between the payment by and the transfer of the promised goods or services to the customer of one year or less would not be subject to this assessment. EFRAG tentatively supported this approach and discussed the appropriateness of the various factors and the practical expedient.

The discussion at the meeting was not conclusive. EFRAG will continue to follow closely the IASB re-deliberations.

IASB Exposure Draft *Leases*

EFRAG considered the latest tentative decisions made by the IASB in its re-deliberations of the proposals included in the Exposure Draft *Leases*, and the preliminary feedback received by the IASB during its outreach activities on the definition of a lease.

In March 2011, the IASB tentatively decided that an asset is a specified asset when it has both quantitative and qualitative specifications. Based on the results of the outreach, during the educational session on 6 April 2011, the IASB staff proposed to the Board to define the “specified asset” as an “identifiable asset” or as an “asset of a particular specification”. This issue is subject to the Board’s re-deliberations at its future meeting. EFRAG reaffirmed its previous position that the definition of a lease should be sufficiently robust to avoid accounting for contracts that, in substance, represent service arrangements as leases.

EFRAG also reaffirmed its preference to include intangible assets in the scope of the new standard on leases, but acknowledged that this concern could not be addressed within the time available for the finalisation of the standard.

The discussion at the meeting was not conclusive. EFRAG will continue to follow closely the IASB’s re-deliberations.

IASB Exposure Draft *Insurance Contracts*

EFRAG received an update on the latest developments in relation to the IASB *Insurance Contracts* project and on the proposed timetable for the completion of the project. The IASB plans to take final decisions on the most critical issues in May and June 2011. The IASB is preparing for those final decisions through various educational sessions on unlocking of the residual margin, an explicit risk adjustment, unbundling, different alternatives for the statement of comprehensive income, and presentation of volatile information. EFRAG did not take any decisions at this meeting, but noted that completion of this project is a key issue.

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

EFRAG has initiated a proactive project to explore the role of an entity’s business model in financial reporting. The project is conducted jointly with the national standard setters of France (ANC) and the UK (UK ASB).

At its December 2010 meeting, EFRAG approved the project plan and the call for candidates for the advisory panel.

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At its April 2011 meeting, EFRAG approved the scope of the project, as follows:

- to gain an understanding of what is meant by the term “business model”,
- to determine if a single working definition of the term can be developed for use in financial reporting and whether business models can be observed and described objectively,
- to examine whether the notion of a business model should play any role in financial reporting.

EFRAG also approved the configuration of the advisory panel. The first panel meeting is planned in June 2011.

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. The objective of the meeting in April 2011 was to finalise the discussions on the key topics of the project, so the project team could proceed with the drafting of a discussion paper.

The project team updated EFRAG on the detailed analysis carried out to determine if and how IFRS 3 *Business Combinations* should be amended to address the specific difficulties arising from transactions under common control. The analysis focused on the following issues: identifying an acquirer, obtaining control over one or more businesses, and determining whether an acquisition is a business as defined in IFRS 3.

EFRAG discussed circumstances in which it may be difficult to identify an acquirer in a business combination under common control. Cases considered included an ultimate parent entity having full discretion in structuring the business combination under common control in such a way that it, and not the entities entering into the business combination transaction, determined the accounting outcome.

EFRAG also discussed the three views on the accounting for a business combination under common control transaction in the financial statements of the acquirer that have emerged in the project:

- *View One: the transaction is “always” a business combination under IFRS 3* – under this view, the substance of a business combination under common control is considered from the perspective of the separate reporting entity. Obtaining control over one or more businesses should be a significant economic event for that separate reporting entity.
- *View Two: the transaction is “never” a business combination under IFRS 3* – under this view, the substance of a business combination under common control is considered from the perspective of the group. From the group point of view, the substance of the transaction is an internal reorganisation that represents only a shift of the legal title from one entity in the group to another. Therefore, under this view, IFRS 3 should never be applied to business combinations under common control.
- *View Three: the appropriate accounting treatment is determined based on the analysis of the substance of the business combination under common control* – under this view, an analysis of the substance of the transaction is carried out to determine whether or not the transaction has economic substance. The analysis of economic substance focuses on whether or not a business combination under common control changes the relative economic interests of those who have a claim against the combining entities. If this is the case, and such a change is likely to be relevant to various groups of users of the financial statements, including existing and potential equity investors, lenders and other creditors, then IFRS 3

should apply. This is because existing and potential investors, lenders and other creditors are only interested in transactions that are likely to have a significant impact on the future cash flows of the combining entities.

EFRAG also decided not to include any analysis related to the implications of business combinations under common control for the separate financial statements in the forthcoming discussion paper. This issue will be raised as questions to constituents and a call for input in order to be addressed at a later stage. A question also will be asked about the disclosures needed.

The project team is planning to finalise the drafting of the forthcoming discussion paper and to present it to EFRAG at its June 2011 meeting.