

September 2013

Summary of EFRAG Technical Expert Group (TEG) and Consultative Forum of Standard Setters meetings September 2013

EFRAG TEG held a conference call on 30 July 2013 to finalise its Draft Comment Letter on the IASB Exposure Draft *Insurance Contracts*.

EFRAG TEG held a conference call on 27 August 2013 to discuss the IASB Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*.

From 3 to 6 September 2013 EFRAG TEG held its monthly meeting. The first two days were held in conjunction with EFRAG CFSS, a whole day being devoted to educational sessions on Rate Regulation in Europe and Macro-hedging. The following topics were discussed at the EFRAG CFSS meeting:

- In preparation of the Accounting Standards Advisory Forum meeting planned on 25-26 September, discussions were held on Leases, the Conceptual Framework, Impairment of Financial Assets, Insurance Contracts, Macro Hedging, and short term possible improvements on disclosures
- Proactive Project *Separate Financial Statements prepared under IFRS*
- IASB Post-implementation Review *IFRS 3 Business Combinations*
- IAS 28 *Accounting for Associates and Joint Ventures*

The following topics were discussed at the EFRAG TEG meeting:

- IASB Project *Revenue*
- EFRAG Proactive Project *Capital Providers' use of financial statements – consequences for standard setting*
- Annual Improvements Project 2012 and 2013
- IASB Exposure Draft *Regulatory Deferral Accounts*
- IASB Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*
- EFRAG Draft Comment Paper *Emission Trading Schemes*
- IFRIC Interpretation 21 *Levies*
- IASB Exposure Draft *Leases*

Highlights

Endorsement Advice

On 12 September 2013 EFRAG published its final endorsement advice and effects study on IFRIC Interpretation 21 *Levies*. For more details see page 6.

Comment letters

On 5 August 2013 EFRAG published its draft comment letter on IASB Exposure Draft *Insurance Contracts*. Comments are requested by 18 October 2013. For more details see page 2.

On 10 September 2013 EFRAG published its final comment letter on IASB Exposure Draft *Regulatory Deferral Accounts*. For more details see page 2.

IASB Exposure Draft *Insurance Contracts*

On a conference call on 30 July EFRAG TEG approved its draft comment letter on the Exposure Draft.

EFRAG TEG members welcomed the changes made in the revised proposals and especially appreciated the efforts made by the IASB to address the accounting mismatch issue, and to distinguish short-term volatility from the long-term performance of an insurer. However, based on the findings of EFRAG's public consultation on long-term investing activities business models, EFRAG's preliminary views include support to presenting in OCI changes in the insurance liabilities arising from changes in interest rate and request for measuring assets invested to back insurance liabilities at fair value through OCI.

Generally EFRAG TEG members agree with the revised proposals relating to adjusting the contractual service margin and the retrospective application of the future standard.

In relation to the measurement and presentation exception for contracts that require the entity to hold the underlying items and specify a link to the returns on those items, EFRAG TEG members expressed concerns that it would apply to limited types of contracts, leading to contracts with similar economic features being treated differently.

EFRAG has not formed a view yet on the IASB's new proposals to present insurance contract revenue in profit or loss. On this topic as on other issues such as the cost/benefit potential trade-off and understandability/feasibility of the proposed requirements, EFRAG will form its view based on the results of the field-test it has organised in coordination with the IASB and National Standard Setters in Europe.

IASB Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*

On a conference call on 27 August 2013 and at its September meeting EFRAG TEG considered a draft comment letter. It is expected that the draft comment letter will be finalised at the EFRAG TEG conference call on 17 September 2013.

At its September meeting EFRAG TEG also discussed Bulletins on complexity and measurement.

Rate-regulation in Europe

At their September joint meeting EFRAG CFSS and TEG received an educational session on the project from members of the EFRAG Rate Regulated Activities Working Group.

The objective of the session was to consider the different rate-regulation regimes in force, including current practices on the accounting for rate-regulated deferred balances across jurisdictions.

No decisions were taken at the meeting.

Macro Hedging

EFRAG CFSS and EFRAG TEG members received an educational session on macro hedge practices in different industries and based on different risks: interest rate risk management in the banking industry from BNP Paribas; asset-liability management in the insurance industry from Allianz and foreign exchange risk management practices in corporates from Novartis.

Accounting Standards Advisory Forum

EFRAG and the European members of the Accounting Standards Advisory Forum prepared for the September meeting of the Accounting Standards Advisory Forum.

Leases

EFRAG CFSS members held a diversity of views but support for the proposed model had developed since the previous exposure draft and that those who supported the projected supported the right of use model as the appropriate depiction of economic reality. Members did not identify significant support for the dual Type A/Type B model. It was also questioned whether changes were required to lessor accounting, or whether the model could be made to work just for lessees. Concern was also expressed whether the proposals have sufficiently eliminated complexity and cost and that the evidence obtained from the field tests EFRAG has performed with National Standard Setters would be important.

Short-term improvements to disclosures

EFRAG CFSS members generally welcomed the amendments and believed they would assist in creating a more consistent understanding of materiality. The proposal to clarify that filtering out immaterial information is necessary to provide relevant information was welcomed. However members noted that information on the absence of something, for example the lack of holdings of financial assets of a particular credit status, may also be relevant.

EFRAG CFSS members welcomed the proposal to clarify that materiality applies to the whole financial statements: an individual item being material did not mean all possible related disclosures were also material.

The proposal to adopt less prescriptive disclosure requirements was not supported: EFRAG CFSS members believed that once there was a better understanding of how to apply materiality, prescriptive wording should remain. In particular, there were concerns that removing prescriptive requirements would put more responsibility for choosing what to disclose in the hands of preparers.

There was support for allowing flexibility in presentation to help explain items, provided that consistency of presentation was maintained unless changes were justified. This was thought necessary in order to ensure that flexibility was not used to confuse users.

EFRAG CFSS members expressed general support for amending the requirements on disclosure of accounting policies so that an entity-specific approach is applied and that knowledge of IFRS is presumed. However, concern was expressed that financial reports may lose their self-sufficiency, making it more difficult to analyse the reports of past years.

Conceptual Framework for Financial Reporting

EFRAG CFSS members considered the Bulletin *Prudence* and the paper from the Australian Accounting Standards Board *Rethinking the Path from an Objective of Economic Decision Making to a Disclosure and Presentation Framework*.

Some noted that requirements in current IFRS reflected prudence (e.g the requirements to measure some assets at the lower of two or more amounts). They thought that these requirements resulted in useful information. However, to understand the requirements and to ensure that prudence would also be reflected in future standards, the concept of prudence should be included in the Conceptual Framework.

Others thought that prudence would result in matched transactions being presented as a (net) liability. This would be the case as prudence would result in liabilities being presented at a higher amount than the matching assets.

On the Australian paper, EFRAG CFSS members thought that it was interesting, but perhaps too ambitious on what financial reporting could achieve. This highlighted the need to specify the boundaries of financial reporting.

Macro Hedging

EFRAG CFSS members indicated that, although the project was still at an early stage, it was important that risk-management practices were reflected to the extent possible in the accounting

requirements. It was also noted that the scope should not be limited to macro fair value hedging and should include risks other than interest rate risk; that a requirement to have all derivatives at fair value through profit or loss introduces supplementary constraints which may generate misalignment of assets and liabilities.

It was also important that behavioural factors, such as those influencing the measurement of core deposits should be taken into account and that it was time to open the debate so a Discussion Paper should be published shortly.

Expected Credit Losses

In the absence of a specific paper for the ASAF meeting as a basis for discussion, EFRAG CFSS members thought that the messages in the EFRAG comment letter on the Exposure Draft were still relevant. In particular the operational difficulties identified by constituents as part of the field test, the quite limited ability to leverage on existing risk management and regulatory practices and the fact that not all necessary data were available.

Insurance

EFRAG CFSS members were presented with a high level summary of the views presented in EFRAG's draft comment letter published on 5 August 2013. At this stage in the due process no conclusions could be reached on the feedback from constituents.

The discussion then focussed on contracts that require an entity to hold underlying items and the alternative industry proposal presented in Appendix 5 of EFRAG's draft comment letter, and the use of OCI in accounting for insurance contracts.

Some members indicated that UK and Swedish insurers use the fair value through profit or loss approach (FVTPL) and are therefore opposed mandatory fair value through OCI (FVOCI) approach as proposed in EFRAG's response. The same members thought that FVTPL should be the first choice allowed with FVOCI being offered as an option. A question was also raised on the use of FVOCI when it came to the treatment of items such as goodwill, deferred tax and treasury shares.

Proactive Project Separate Financial Statements prepared under IFRS

At its September 2013 meeting, EFRAG CFSS members received an update on this EFRAG/OIC/DASB/ICAC project and more specifically on the European outreach to users of Separate Financial Statements. They briefly considered some particular aspects linked to common control transactions.

Outreach activities on the Review of the Conceptual Framework

At its September 2013 meeting, EFRAG CFSS members were reminded of the upcoming outreach and informed of the progress in organising these events.

IASB Post-implementation Review IFRS 3 Business Combinations

EFRAG CFSS discussed European involvement in the Post-implementation Review. Members thought that the topics identified seemed to draw significantly on the experiences of preparers and auditors, with limited input from users and that a special effort should take place to obtain input from users. There was also a question about when the IASB would conclude on the final list of issues that would be included in the request for information.

IAS 28 Accounting for Associates and Joint Ventures

EFRAG CFSS members discussed two papers relating to the equity method under IAS 28. One paper looked at the conceptual and historic background to the equity method, exploring whether it was a one-line consolidation or a measurement basis. Comments on recent Exposure Drafts

identified that this was the root cause for the different views held by constituents. It was agreed that this paper illustrated the complexities of the equity method, and should be considered for public consultation. EFRAG would discuss a revised draft of the paper at a future EFRAG TEG meeting.

The second paper was to obtain early input from EFRAG CFSS members on a forthcoming Exposure Draft on elimination of gains arising from downstream transaction between an investor and its investee. No decisions were taken at the meeting.

IASB Project Revenue

At its September 2013 meeting EFRAG TEG considered what information was needed in order to form an endorsement advice on the forthcoming standard. It was noted that it would be beneficial to have the information before the standard was issued for the IASB to be able to address any critical issues in the standard.

EFRAG Proactive Project *Capital Providers' use of financial statements - consequences for standard setting*

EFRAG TEG considered a short paper on the consequences for standard setting of a literature review performed on the use of financial reporting information. EFRAG TEG decided to consider the paper further at a future meeting.

Annual Improvements Project 2012 and 2013

The IASB is expected to issue by the end of 2013 two documents within the Annual Improvement Project, the *Annual Improvements to IFRSs 2010–2012 Cycle* and *Annual Improvements to IFRSs 2011–2013 Cycle*.

At its September meeting, EFRAG TEG tentatively identified the amendments that the staff should assess while preparing the draft endorsement advices.

IASB Exposure Draft *Regulatory Deferral Accounts*

EFRAG TEG approved the comment letter in response to the Exposure Draft. EFRAG does not support the proposals as they reduce comparability, in the same jurisdiction, between entities that take advantage of the proposals and entities that already apply IFRS or did not wish to apply the requirements of the Exposure Draft when they first adopt IFRS. Furthermore, the proposals are not limited to facilitating first-time adoption but maintained previous accounting policies for an indefinite period.

Although EFRAG believes that this interim project should not be pursued, EFRAG supports the IASB's decision to make the standard an option and of its efforts to limit comparability issues to the regulatory deferral account balances.

EFRAG Draft Comment Paper *Emission Trading Schemes*

In December 2012 EFRAG published its Draft Comment Paper 'Emission Trading Schemes' responding to a paper issued in May 2012 by the French standard setter *Autorité des Normes Comptables (ANC) Proposals for Accounting for GHG Emission Rights reflecting companies' business models*. EFRAG decided to comment on that paper as a basis to stimulate the debate.

During the September EFRAG TEG meeting, EFRAG staff presented a comment letter analysis which showed the variety on views held, especially regarding the accounting treatment for rights held to settle the emission obligations (and not for trading).

EFRAG TEG members requested EFRAG staff to finalise the feed-back statement for publication and to develop specific proposals regarding possible next steps.

IFRIC Interpretation 21 *Levies*

EFRAG TEG discussed and approved the final Endorsement Advice.

EFRAG staff presented the analysis of comments received on the Draft Endorsement Advice. The majority of respondents agreed with the advice to endorse the Interpretation but two respondents, both from France, did not agree with EFRAG's initial assessment to recommend endorsement because they believed that for certain levies IFRIC 21 would not provide relevant information, more particularly in interim accounts. The discussion at EFRAG TEG reflected former strong recommendations from Europe to the IFRS IC not to pursue their draft interpretation; however there is consensus that the interpretation is consistent with current endorsed IFRS and a majority view emerged that the interpretation meets technical endorsement criteria.

In view of the concerns raised, EFRAG TEG considered recommending postponing the endorsement in the EU until the completion of the new Conceptual Framework. However, it was noted that completion of the Conceptual Framework will take years. In the meantime, even if IFRIC 21 was not endorsed, entities would be strongly challenged if they decided not to comply with its requirements.

EFRAG TEG approved to recommend the endorsement of IFRIC 21 with two members dissenting. EFRAG TEG also approved the effects study.

IASB Exposure Draft *Leases*

EFRAG TEG held an educational session, receiving a summary of the outcomes of different outreach activities and other activities performed over the summer, with a view to obtain additional input in preparation of the discussion for the final comment letter.

EFRAG staff explained the feedback from meetings with users. While a majority of users supports recognition of leases on the balance sheet, some users would prefer to receive additional information in the notes or would limit recognition only to some types of leases.

Those who supported recognition do not necessarily agree about what the appropriate measurement is. Users in general disapproved of having two different measurement bases for the right of use asset.

EFRAG staff illustrated an analysis of the potential impact of adopting the new accounting approach in Europe. Operating lease commitments are approximately 10 times higher than finance leases that are recognised on the balance sheet. While the overall impact compared to total liabilities may be seen as limited (approximately 2% of total liabilities), the impact varies greatly across industries with retailers, transport and hotels among those that are affected the most.

EFRAG TEG members asked the staff to provide additional information and disaggregate amounts by country.

Finally, EFRAG staff discussed the preliminary results of the field-testing initiative with more than 40 companies across Europe. Respondents expressed significant concerns about cost and complexity of implementing the proposals. In particular, concerns were expressed around allocating the contract payments between lease and service components, how the future performance of the business should affect the assessment and reassessment of lease term and the scope of proposed disclosures.