

Summary of EFRAG meetings held in July - September 2010

On 23 July 2010, EFRAG held a meeting by public conference call to discuss:

- FASB Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*
- IASB project *Annual Improvements 2008-2010*
- IASB Exposure Draft *Revenue Recognition: Revenue from Contracts with Customers*.

On 8-10 September 2010, EFRAG held its monthly meeting and discussed:

- IASB Exposure Draft *Insurance Contracts*
- IASB Exposure Draft *Leases*
- EFRAG Proactive project *Effects of Accounting Standards*
- EFRAG Proactive project *Business Combinations under Common Control*
- EFRAG Proactive project *Corporate Income Tax*
- IASB Exposure Draft *Defined Benefit Plans (Proposed amendments to IAS 19)*
- EFRAG outreach on IASB project *Financial Statement Presentation*
- IASB Exposure Draft *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (Limited re-exposure of proposed disclosure)*
- EFRAG joint project with FEE *Possible Impact of Later Phases of IFRS 9 on Classification and Measurement of Financial Assets*
- IASB project *Hedge Accounting*
- IFRS Interpretations Committee tentative agenda decision *IAS 32 Financial Instruments: Presentation — Put options written over non-controlling interests*.

Highlights

Endorsement advice

EFRAG finalised the endorsement advice to the European Commission on the *Improvements to IFRSs 2008-2010* (page x).

Comment letters to the IASB

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

- Exposure Draft *Defined Benefit Plans (Proposed amendments to IAS 19)*. The comment letter welcomes the ED as short-term improvements to employee benefit accounting pending the debate on fundamental issues related to both pensions and performance reporting. EFRAG supports only those proposals in the ED, which either remove options and thus enhance comparability or enhance consistency with IAS 19 measurement principle. (page 5). →

Highlights (continued)

Comment letters to the IASB (continued)

- Exposure Draft *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (Limited re-exposure of proposed disclosure)*. The comment letter supports the proposed changes to the measurement uncertainty analysis disclosure (page 5).

In July 2010, EFRAG invited comments on its draft comment letter to the IASB on the Exposure Draft *Revenue Recognition: Revenue from Contracts with Customers*. The draft comment letter overall does not support the control model for revenue recognition; however it is supportive of the IASB proposals for combining and segmenting contracts, contracts modifications and separating performance obligations. The comment deadline is 22 September 2010 (page 3).

Comment letter to the FASB

In July 2010, EFRAG invited comments on its draft comment letter to the FASB and the IASB on the FASB Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*. The comment period closed on 13 September 2010 (page 2).

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

During its meeting held by public conference call on 23 July 2010, EFRAG finalised its draft comment letter in response to the FASB Exposure Draft FASB Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (the ED).

The draft comment letter argues that the FASB proposals do not provide a basis for a high-quality standard on accounting for financial instruments, and indicates EFRAG's support for the broad direction set by the IASB in its project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. In particular, EFRAG supports the following:

- the classification criteria based on the characteristics of the financial instruments and the business model used by the entity in managing those financial instruments;
- a mixed measurement model that allows for financial instruments to be reported at either amortised cost or fair value, depending on the business model;
- primary financial statements that reflect one measurement attribute only;
- impairment of financial assets measured at amortised cost based on an expected loss approach that uses all available credit-related information, including forecasts of future events and future economic conditions; and
- when financial liabilities are measured at fair value for the sole purpose of reducing accounting mismatches, changes in fair value of a financial liability due to changes in an entity's own credit risk should not be recognised in profit or loss.

In addition, EFRAG's draft comment letter includes recommendations on how the IASB proposals could be further improved to form the basis of a high quality (possibly single) standard on accounting for financial instruments. The draft comment letter is available on EFRAG's website. The comment period closed on 13 September 2010.

As part of its ongoing contribution to the IASB's due process, EFRAG has invited analysts, investors and regulators to an outreach event dedicated to the accounting for financial instruments, which is scheduled for 15 September 2010. The feedback received during this outreach event will be considered in finalising EFRAG's comment letter to the FASB. The comment letter on the ED is expected to be finalised at the EFRAG meeting scheduled for 22 September 2010.

In May 2010, EFRAG issued a draft endorsement advice and its draft effects study report in respect of the *Improvements to IFRSs 2008-2010*, which were published by the IASB in May 2010. Based on the comments received, on 23 July 2010 EFRAG issued to the European Commission the positive endorsement advice and the effect study report.

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

During its meeting held by public conference call on 23 July 2010, EFRAG finalised its draft comment letter in response to the IASB Exposure Draft *Revenue Recognition: Revenue from Contracts with Customers* (the ED). The draft comment letter welcomes the work carried out on the subject, but expresses concern that the ED has been issued without a thorough conceptual debate on why revenue is an important figure, what it should represent and why it provides useful information.

Overall, EFRAG does not support the control model proposed in the ED and considers that the IASB has not explained why the proposals would result in useful information. EFRAG believes that revenue should reflect the activity carried out by an entity pursuant to a contract with a customer. That is, revenue should be recognised as an entity progresses towards the fulfilment of a performance obligation when it has an irrevocable right to consideration subject to continued performance. However, EFRAG supports some aspects of the proposals in the ED, including the guidance on: combining and segmenting contracts, contract modifications, and separating performance obligations.

In addition, EFRAG is undertaking an outreach programme to understand more clearly the impact of the proposals in the ED on specific industries. In this regard, EFRAG seeks input from constituents via a separate questionnaire. The draft comment letter and the questionnaire are available on EFRAG's website. The comment deadline for both is 22 September 2010.

IASB Exposure Draft *Insurance Contracts*

EFRAG discussed its draft comment letter in response to the IASB Exposure Draft *Insurance Contracts* (the ED) considering input from the EFRAG's Insurance Accounting Working Group. EFRAG expressed tentative support for a number of proposals in the ED, including the proposed measurement model based on fulfilment cash flows, and the proposed building block approach, which considers separately a risk adjustment and a residual margin. However, EFRAG tentatively confirmed its concerns about the proposals in the ED related to subsequent measurement of the residual margin, the summarised presentation of margin on the face of the statement of comprehensive income and the transition requirements. These proposals were discussed during the July 2010 meeting, and details of the discussion can be found in the July 2010 issue of the EFRAG Update.

In addition, EFRAG tentatively decided to include in its draft comment letter a concern expressed by constituents that the interaction of the proposals in the ED and the requirements in IFRS 9 *Financial Instruments* was not considered to a sufficient degree. EFRAG tentatively agreed that the draft comment letter would seek input from constituents on the following:

- *Scope* – the exclusion of some fixed fee contracts from and inclusion of financial guarantee contracts in the scope of the ED.
- *Liquidity premium* – whether it should be taken into account in determining the discount rate.
- *Unbundling requirements* – whether the unbundling requirements are sufficiently developed.
- *Interaction of the ED and IFRS 9.*

The draft comment letter on the ED is expected to be finalised shortly and will be available on EFRAG's website.

EFRAG continued discussing its draft comment letter in response to the IASB Exposure Draft *Leases* (the ED). The following key messages were agreed for the draft comment letter:

- *Scope* – EFRAG tentatively confirmed its disagreement with the exclusion of intangible assets leases from the scope of the ED.
- *Lessee accounting* – EFRAG tentatively confirmed its support for the right-of-use model for lessees, subject to a clear and operational distinction between leases and service agreements.
- *Lessor accounting* – EFRAG tentatively confirmed its concerns about the complexity of the “hybrid” accounting model for lessors, which is based on the derecognition model and the performance obligation model, and confirmed its preference for a single partial derecognition model.
- *Renewal options and contingent rents* – EFRAG tentatively confirmed its disagreement with the proposal 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 and with the proposal to include in initial measurement of lease receivables or lease payables contingent rents based on probability-weighted estimates. EFRAG expressed its tentative support for separate measurement of options to purchase and extend a lease.
- *Sale and leaseback transactions* – EFRAG expressed its tentative disagreement with the proposals in the ED in respect of the sale and leaseback transactions and considered an alternative approach, which will be included in the draft comment letter.

The draft comment letter on the ED is expected to be finalised at a public conference call scheduled for 20 September 2010.

EFRAG Proactive project *Effects of Accounting Standards*

EFRAG and the national standard setter of the UK (UK ASB) have been working together on a proactive project, which considers the effects of Accounting Standards. At this meeting, EFRAG considered a paper providing an update on the project, which will be presented at the meeting of National Standard Setters scheduled for 18-19 September 2010. It is expected that the project will result in the publication of the Proactive Discussion Paper (the DP) in the first quarter of 2011. The purpose of the DP is to put forward, for public comment, proposals to integrate (or further embed) into the standard-setting due process a systematic approach for considering the effects of accounting standards as those standards are developed and implemented. No decisions were taken.

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 a paper providing an update on the project, which will be presented at the meeting of National Standard Setters scheduled for 18-19 September 2010. No decisions were taken.

EFRAG Proactive project *Corporate Income Tax*

EFRAG and the national standard setters of the UK (UK ASB) and Germany (GASB) jointly conduct a proactive project on Corporate Income Tax. During this meeting, EFRAG discussed a paper providing an update on the project, which will be presented at the meeting of National Standard Setters scheduled for 18-19 September 2010. No decisions were taken.

IASB Exposure Draft *Defined Benefit Plans (Proposed amendments to IAS 19)*

EFRAG finalised its comment letter in response to the IASB Exposure Draft *Defined Benefit Plans (Proposed amendments to IAS 19)* (the ED). The comment letter welcomes the ED as short-term improvements to employee benefit accounting pending the debate on fundamental issues related to both pensions and performance reporting. EFRAG supports those proposed changes to employee benefit accounting, which either remove options and thus enhance comparability or enhance consistency with IAS 19 measurement principle. However, EFRAG does not support other proposed changes and believes that a comprehensive review of employee benefit accounting is necessary to bring significant improvement to the financial reporting of employee benefits and define proper accounting for the hybrid pension schemes, which combine features of defined benefit and defined contribution plans.

EFRAG outreach on IASB project *Financial Statement Presentation*

Following the release of the IASB staff draft of the Exposure Draft Financial Statement Presentation (the Draft ED), in July 2010 EFRAG decided to organise outreach events on the Financial Statement Presentation project. The objective of the outreach events is to assist the IASB in its efforts to gather views from European constituents on the tentative decisions included in the Draft ED and to inform itself of whether, and to what extent, EFRAG preliminary views are representative of European views. The outreach events will be held throughout Europe from September to November 2010, in partnership with European National Standard Setters. As part of the outreach activities, EFRAG decided to publish a focus paper, which is intended to stimulate the debate by European constituents on the proposals included in the Draft ED and will serve as a basis for the outreach events in Europe.

During its September 2010 meeting, EFRAG members received an update on the arrangements for various meeting with constituents across Europe and discussed the draft of the focus paper, which is intended to be published for public comments by the end of September 2010.

The detailed information about EFRAG outreach activities on the Financial Statement Presentation project is available on EFRAG's website.

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

EFRAG finalised its 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 comment letter supports the proposed changes to the measurement uncertainty analysis disclosure. In particular, the comment letter:

- welcomes the clarification that the analysis is focussed on unobservable inputs and by implication provides information about measurement uncertainty as opposed to market risk;
- supports the rationale for changing the wording “reasonably possible alternative assumptions” and the convergence objective it achieves;
- agrees that correlation is an important factor in providing a meaningful analysis of measurement uncertainty where relevant; and
- agrees that correlation should only be considered in instances where its effect on the fair value measurement is significant.

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Through its due process EFRAG noted that while most constituents agree that correlation provides useful information there are divergent interpretations of how to determine this correlation.

EFRAG also decided to use this opportunity to issue a letter reiterating certain key messages included in its comment letter relating to the IASB Exposure Draft Fair Value Measurement dated 16 October 2009. This letter urges again the IASB to consult constituents regarding its review of the applicability of fair value as defined in the IASB staff draft IFRS Fair Value Measurement. Furthermore, in EFRAG's view the IASB should reconsider the labels in standards outside the scope of the fair value measurement standard.

EFRAG joint project with FEE *Possible Impact of Later Phases of IFRS 9 on Classification and Measurement of Financial Assets*

EFRAG and FEE have undertaken jointly a project to examine whether and how later phases in the development of IFRS 9 *Financial Instruments* could have an influence on where the boundary between amortised cost and fair value should fall in practice, and whether bifurcation of embedded derivatives could be based on some principle rather than on the existing rules in IAS 39 *Financial Instruments: Recognition and Measurement*. EFRAG and FEE have set up an ad hoc working group to look into this issue.

EFRAG members received an update on this project and encouraged further work on this issue.

IASB project *Hedge Accounting*

EFRAG staff updated the members on the developments of the IASB project *Hedge Accounting* focusing on the evolution of IFRS in this area. The update covered the developments from the issuance of the revised IAS 39 *Financial Instruments: Recognition and Measurement* in 2003, included the background for the EU carve-out and provided a concise overview of the current IASB project to date. No decisions were taken at this meeting.

IFRS Interpretations Committee tentative agenda decision *IAS 32 Financial Instruments: Presentation – Put options written over non-controlling interests*

The IFRS Interpretations Committee (the Committee) received a request for guidance on accounting for changes in the carrying amount of a financial liability for a put option, written over shares held by a non-controlling interest (NCI), in the consolidated financial statements of a parent.

There is a potential conflict between the guidance in IAS 27 *Consolidated and Separate Financial Statements* and IAS 39 *Financial Instruments: Recognition and Measurement*. The potential conflict arises because IAS 27 requires transactions with NCI to be recognised in equity, whilst IAS 39 requires subsequent measurement of the liability through profit or loss.

Following its September 2010 meeting, the Committee published a tentative agenda decision not to take the issue on to their agenda but instead refer it to the Board to be addressed as part of the IASB project *Financial Instruments with Characteristics of Equity*. The Board is planning to discuss this issue at its meeting on 14 September 2010. The drafting of the tentative agenda decision focuses on the IAS 39 requirements only and does not provide a description of the potential conflict between two standards.

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When the Committee started publishing wording for tentative agenda decisions, EFRAG decided to respond to the Committee's tentative agenda decisions on an exception basis, that is, when EFRAG's constituents believe that they are expected to have a significant effect on the way IFRSs are applied. Until now our constituents had not raised such concerns. However, our constituents have raised concerns in respect of the Committee's tentative agenda decision on put options written over non-controlling interests.

EFRAG discussed the Committee's decision not to take this item onto its agenda and whether the wording of the decision should be changed to explain *only* that there is an inconsistency between IAS 39 and IAS 27. EFRAG agreed to consider its further actions following the decision made by the Board at its meeting on 14 September 2010.

Future meetings

The next meetings of EFRAG TEG will take place on 22 September and 6-8 October 2010.

Conference call is scheduled for 20 September 2010.