

January 2013

Summary of EFRAG Technical Expert Group meeting January 2013

EFRAG TEG held a conference call on 20 December 2012 to discuss EFRAG comment letters on:

- IASB Exposure Draft *IAS 28 Equity Method: Share of Other Net Asset Changes*
- IASB Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9*
- IASB Review Draft *IFRS 9 Financial Instruments: Chapter 6 - General Hedge Accounting*
- IFRS Interpretations Committee Tentative Rejection Notice *Negative interest rates: implications for presentation in the statement of comprehensive income*

On 16 and 17 January 2013, EFRAG TEG held its monthly meeting. The following topics were discussed:

- IASB Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*
- IASB Exposure Draft *Acquisition of an Interest in a Joint Operation*
- Canadian Institute of Chartered Accountants discussion paper *Toward a Measurement Framework for Financial Reporting by Profit-Orientated Entities*
- IASB Project *Insurance Contracts*
- EFRAG/FRC Proactive Project *Improving the Financial Reporting of Income Tax*
- IFRS Interpretations Committee Tentative Rejection Notice *Negative interest rates: implications for presentation in the statement of comprehensive income*
- IASB Project *Conceptual Framework*
- IASB Project *Leases*
- EFRAG Proactive Project *Separate Financial Statements*
- IASB Review Draft *IFRS 9 Financial Instruments: Chapter 6 - General Hedge Accounting*
- IASB Project *Impairment*
- IASB Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9*
- IASB Project *Revenue Recognition*

Highlights

Comment Letters

IASB Exposure Draft *IAS 28 Equity Method: Share of Other Net Asset Changes*

EFRAG issued its draft comment letter on the Exposure Draft, which agrees that diversity in practice exists on how investors should recognise their share of the changes in the net assets of an investee that are not recognised in profit or loss or other comprehensive income of the investee, and are not distributions received ('other net asset changes'). EFRAG did not reach a consensus on the appropriate treatment, and requests constituents comment on three views.

Comments are requested by 28 January 2013.

For more information see page 2.

IASB Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9*

EFRAG issued its draft comment letter on the Exposure Draft, welcoming the IASB's decision to amend IFRS 9. However EFRAG had concerns that there would remain a number of financial assets that would not pass the contractual cash flow characteristics test, for a number of reasons, despite the fact that an amortised cost measurement basis would provide the most useful information.

Comments are requested by 18 March 2013.

For more information see page 3.

IASB Review Draft *IFRS 9 Financial Instruments: Chapter 6 - General Hedge***Accounting**

EFRAG TEG approved a letter to the IASB following field-testing of the Review Draft. The letter contains fatal flaws identified during the field-test and input to the IASB's effect analysis process.

EFRAG TEG also approved a supplementary draft comment letter on the interaction with current macro-hedging practices given the decoupling of the IASB's macro and general hedge accounting projects.

Comments are requested by 21 February 2013.

For more information see page 3

IFRS Interpretations Committee Tentative Rejection Notice *Negative interest rates: implication for presentation in the statement of comprehensive income*

EFRAG issued a final comment letter to the IFRS Interpretations Committee in relation to their tentative rejection notice. EFRAG noted that the language included in the rejection notice was interpretative in nature, and urged the IFRS Interpretations Committee not to issue any rejection notice that would effectively prescribe a specific accounting treatment.

For more information see page 4.

IASB Exposure Draft *IAS 28 Equity Method: Share of Other Net Asset Changes*

In a conference call on 20 December 2012, EFRAG TEG approved a draft comment letter in response to the Exposure Draft. In its draft comment letter, EFRAG agreed that diversity in practice existed on how investors should recognise their share of the changes in the net assets of an investee that are not recognised in profit or loss or other comprehensive income of the investee, and are not distributions received ('other net asset changes'). EFRAG therefore supported the IASB's efforts to address the issue.

However, EFRAG TEG members had divergent views on the accounting for other net asset changes by an investor. Some EFRAG TEG members agreed that other net asset changes should be recognised in equity and reclassified to profit or loss when the investor discontinues the use of the equity method (the IASB's proposal). Some other EFRAG TEG members believed that the investor should only recognise changes in the investee's net assets that arise from profit or loss, other comprehensive income and distributions received. A third group of EFRAG TEG members believed that the investor should account for the investee's other net asset changes that result in indirect decreases and increases in the investor's ownership interest in the same way as actual disposals and acquisitions of interest in the investee. Under the second and third view, reclassification into profit or loss would not be necessary.

The draft comment letter was issued on 21 December 2012. Comments are invited on the draft comment letter by 28 January 2013.

IASB Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9*

In a conference call on 20 December 2012, EFRAG TEG approved EFRAG's draft comment letter in response to the Exposure Draft. In its draft comment letter, EFRAG welcomed the IASB's decision to consider making limited amendments to IFRS 9 and appreciated the effort made to address accounting mismatches arising from the application of different measurement models to financial assets and insurance liabilities. However, EFRAG expressed concern that there are still financial assets that would not pass the contractual cash flow characteristics test, for a number of reasons, despite the fact that an amortised cost measurement would provide more useful information. EFRAG also believed that the definition of interest in IFRS 9 should be revised to clarify that it includes other components which are inherent in any theoretical definition of interest (e.g. liquidity risk).

EFRAG TEG members did not reach a consensus on the IASB's proposal for the introduction of a third business model in IFRS 9. Some EFRAG TEG members believed that eligible debt instruments should be mandatorily measured at Fair Value Through Other Comprehensive Income if they are held within a business model whose objective is both to collect contractual cash flows and to sell (the approach taken by the ED), whereas some other EFRAG TEG members suggested that entities should be able to elect at initial recognition to measure eligible debt instruments at Fair Value Through Other Comprehensive Income only if doing so reduced or eliminated accounting mismatches.

EFRAG invites constituents to (i) comment on the views above, (ii) provide further examples of financial assets that would not pass the contractual cash flow characteristics even when amortised cost measurement would provide more useful information, and (iii) comment on the IASB's decision and other related aspects of not reintroducing bifurcation for financial assets.

The draft comment letter was issued on 31 December 2012. Comments are invited on the draft comment letter by 18 March 2013.

At the January EFRAG TEG meeting, as part of the process of preparing EFRAG's final comment letter, EFRAG TEG discussed a number of examples of financial assets that might not satisfy the contractual cash flows characteristics test, and for which in their view, measurement other than Fair Value Through Profit or Loss would provide more useful information.

No decisions were taken at this meeting.

IASB Review Draft *IFRS 9 Financial Instruments: Chapter 6 - General Hedge Accounting*

During its December conference call EFRAG TEG discussed a draft letter to the IASB on the Review Draft and the reactions received, in particular in relation to macro hedge accounting. EFRAG TEG members were also informed on the outcome of a conference call EFRAG staff held with the IASB staff to clarify the transition between IAS 39 and IFRS 9.

At its January 2013 meeting, EFRAG TEG discussed and agreed to issue a letter to the IASB on the Review Draft, which reflects the results of the field-test carried out by EFRAG in partnership with the ANC, ASCG, FRC and OIC.

EFRAG's letter provides comments in two parts: first, an overview of the implementation difficulties, including fatal flaws and requests for additional guidance. These relate to the use of net positions, the tensions between economic hedges and hedge accounting, the treatment of basis risk in cross currency interest rate swaps, the own use exception and the treatment of time value and forward points.

Second, EFRAG's letter provides input to the IASB's effect analysis. The field-test confirmed that there are a series of common hedging strategies for which hedge accounting continues not to be

permitted, even though the objective set for the IASB's project was to reflect risk management practices. EFRAG acknowledges that the IASB has deliberated in its due process every related limitation to the hedge accounting model. However the IASB's reasoning in its basis for conclusions has remained somewhat limited.

EFRAG strongly recommends that the IASB reviews its reasoning for maintaining the proposed limitations when finalising its effect analysis of the project, so that constituents can fully understand why lifting those limitations would impair good quality financial reporting. The issues relate to the application of hedge accounting to a net position with foreign currency risk, the treatment of credit risk and the sub-LIBOR issue.

At the January 2013 meeting EFRAG TEG also approved a supplementary draft comment letter in which it identifies a number of concerns regarding the impact of the Review Draft on macro hedging. These concerns result from the IASB's decoupling of the project on macro-hedging for open portfolios from the general hedge accounting project.

In the draft comment letter, EFRAG holds the view that IAS 39 requirements applicable to macro-hedging should remain applicable in their entirety – cash flow macro hedging included – until the IASB completes its now separate project on macro hedging. This would avoid successive changes to open-portfolio hedge accounting and be in conformity with the various announcements made by the IASB when the decoupling approach was introduced.

The comment period runs up to 21 February 2013.

IFRS Interpretations Committee Tentative Rejection Notice *Negative interest rates: implications for presentation in the statement of comprehensive income*

During its conference call on 20 December 2012, EFRAG TEG approved a draft comment letter to the IFRS Interpretations Committee about their tentative rejection notice. EFRAG noted that the language included in the rejection notice was interpretative in nature, and urged the IFRS Interpretations Committee not to issue any rejection notice that would effectively prescribe a specific accounting treatment.

The comment period lasted until 15 January 2013. Comments received were discussed at the January 2013 EFRAG TEG meeting, and the final letter, which contained the same message, was published on 17 January 2013.

IASB Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*

In its January 2013 meeting, EFRAG TEG members discussed a draft comment letter in response to the IASB's Exposure Draft. EFRAG TEG members considered that there was an inconsistency between guidance provided in IAS 28 and IFRS 10 when dealing with the accounting treatment for loss of control of a subsidiary and that the proposed amendments could have the merit of being a short-term pragmatic solution to address diversity in practice. EFRAG TEG members were concerned that the proposed amendments would require an entity to determine whether the asset being sold or contributed meet the definition of a business under IFRS 3 *Business Combinations* and it would raise other issues within IFRS 10 and IAS 28. EFRAG thought that the IASB should also consider a number of subjects not included in the scope, such as contributions to Joint Operations.

A revised draft comment letter will be discussed in an EFRAG TEG conference call on 29 January 2013.

IASB Exposure Draft *Acquisition of an Interest in a Joint Operation*

EFRAG TEG discussed a draft comment letter on the Exposure Draft issued by the IASB on 13 December 2012. The IASB proposes that a joint operator should apply the relevant principles for business combinations accounting in IFRS 3 *Business Combinations* and other IFRS, when acquiring an interest in a joint operation whose activity constitutes a business as defined in IFRS 3.

EFRAG TEG members supported the IASB's proposals on the basis that it is a narrow scope amendment to IFRS 11 *Joint Arrangements* that addresses current diversity in practice on how to account for acquisitions of interests in a joint operation whose activity constitutes a business.

However, the discussion highlighted the potential difficulties in practice to distinguish a joint operation from a joint venture and the fact that the IASB's proposals would lead, in many cases, to the recognition of 'goodwill' that could largely reflect the recognition of deferred tax liabilities, which would not have been recognised under the initial recognition exemption in IAS 12 for temporary differences on the initial recognition of assets.

Finally, EFRAG TEG members also raised concerns regarding the scope of the IASB's proposals and particularly the way they would interact with the requirements in IFRS 11 and other amendments being currently developed by the IASB.

A revised draft comment letter will be discussed in an EFRAG TEG conference call on 29 January 2013.

Canadian Institute of Chartered Accountants discussion paper *Toward a Measurement Framework for Financial Reporting by Profit-Orientated Entities*

EFRAG TEG considered the comments received in response to its draft comment letter in response to the paper 'Toward a Measurement Framework for Financial Reporting by Profit-Oriented Entities' published by the Canadian Institute of Chartered Accountants ('the paper').

In its final comment letter, EFRAG agreed with the paper that stewardship should be considered when determining how to measure assets and liabilities. EFRAG also agreed with the paper that if a measurement basis in practice would result in estimates with large margins of errors, disclosure about the uncertainty cannot solve this problem. Instead another measurement basis should be chosen.

EFRAG, however, disagreed with the proposed model for measuring assets and liabilities. The paper proposed that Current Market Value is the most ideal (relevant) measurement basis, when the value is practicable of faithful representation. The paper also proposed that matching current input costs sacrificed against current revenues is a better starting point for estimating an entity's future sustainable earning than historical cost-based accounting, and reflecting holding gains and losses on input assets and liabilities always provides useful information.

EFRAG did not believe that it would be possible to identify an ideal measurement basis. Instead the role of a measurement framework should be to explain the properties of various bases of measurement and, by reference to empirical evidence on various users' needs, provide directions on when the different properties are important. In doing so, implications of a measurement basis on both an entity's financial position and performance should be considered. A measurement framework should also take into account that the information that is most relevant for estimating future cash flows might not be most relevant for assessing stewardship and that different types of users would likely have different needs.

EFRAG considered that reporting holding gains and losses on input assets and liabilities was irrelevant if the entity was not generating its cash flows from holding and selling these assets and liabilities. For self-constructed assets, the reported holding gains and losses may even represent

very abstract information as it may be impossible to re-sell input assets that have been used to create other assets.

EFRAG believed that information about actual cash flows is often considered more useful for predicting future cash flows than information about hypothetical cash flows.

IASB Project *Insurance Contracts*

EFRAG TEG members were provided with an educational session on the IASB's tentative decisions on unbundling and disaggregation of components of insurance contracts and the transitional requirements.

EFRAG/FRC Proactive Project *Improving the Financial Reporting of Income Tax*

At its January 2013 meeting, EFRAG TEG discussed a draft feedback statement, summarising the comment letters received on the Discussion Paper *Improving the financial reporting of Income Tax*. This feedback statement included the recommendations made in November 2012 both by EFRAG TEG and the FRC, EFRAG's partner in the project on future steps. EFRAG TEG approved the draft feedback statement for publication.

The document, which includes a recommendation on the chosen pathway forward, will be communicated to the EFRAG PRC at its meeting in February 2013.

IASB Project *Conceptual Framework*

The IASB is expected to issue a discussion paper on the revision of the Conceptual Framework in July 2013. To prepare itself and its constituents for their comments in response to this discussion paper, EFRAG will, among other things, issue short discussion papers (called bulletins) in partnership with National Standard Setters. At its January meeting, EFRAG TEG considered bulletins on:

- The role of prudence in the Conceptual Framework;
- The role, definition and place of probability; and
- The trade-off between relevance and reliability/faithful representation

IASB Project *Leases*

EFRAG TEG members continued the discussion of the issues for the draft comment letter on the upcoming IASB exposure draft.

On sales and leaseback transactions, some members expressed an opinion that the full derecognition approach might be acceptable in general. However, some concerns were expressed over both the pattern of gain recognition and the applicability of revenue recognition criteria to these transactions.

EFRAG TEG also discussed a number of issues in lessor accounting, including the new model; some members perceived an inconsistency in the treatment of some types of leases (leases for which the expected consumption of benefits is expected to be insignificant) between lessors and lessees. EFRAG TEG members also asked the EFRAG staff to prepare illustrative examples to understand better the accretion of the interest on the residual asset, and the determination of the residual when the lease rate incorporates expectations of variable lease payments.

EFRAG TEG agreed on the proposed treatment of leases denominated in foreign currencies. On impairment, EFRAG TEG members discussed what cash flows the lessor should consider when testing the lease receivable.

At the next EFRAG TEG meeting there will be a session to discuss all the remaining issues on presentation, disclosures, and modifications of contracts; the definition of a lease will also be brought back for discussion.

EFRAG Proactive Project *Separate Financial Statements*

In its January 2013 meeting, EFRAG TEG discussed two topics presented by EFRAG staff: common control transactions and Business Combinations under Common Control (BCUCC) for Separate Financial Statements. A majority of the EFRAG TEG members expressed the view that the legal boundaries of a parent company was important, and that Separate Financial Statements and Consolidated Financial Statements were designed for different purposes, which should affect the way Business Combinations and BCUCC in particular should be accounted for. EFRAG TEG asked that the project team clarify a number of issues to be re-discussed at a later stage. The project team indicated that the next step should be to gather information through the planned outreach to users of Separate Financial Statements, so as to better understand their needs. EFRAG TEG also stressed the importance of putting the emphasis on real-life examples.

IASB Project *Impairment*

At its January meeting, EFRAG TEG had an initial discussion on its future outreach activities in response to the IASB's forthcoming Exposure Draft on impairment. EFRAG will further discuss how to move forward at its February meeting. No decisions were taken at this meeting.

IASB Project *Revenue Recognition*

At the January 2013 meeting, EFRAG TEG members received an update on the latest tentative decisions of the IASB. It was noted that these decisions addressed many of EFRAG's concerns related to the 2011 ED. However, the tentative decisions would not necessarily resolve all EFRAG's concerns. For example, the tentative decisions did not deal with the allocation of the transaction price to contracts with more goods and services when the marginal cost of providing these goods or services would be close to nil and the price charged for these goods or services would vary considerably from customer to customer.

EFRAG TEG member were also unsure on whether the decisions would solve the difficulties identified for some industries in applying the proposals and whether the removal of a specific requirements on when to recognise revenue related to sales-based royalty types of contracts would have unintended consequences.