EFRAG

European Financial Reporting Advisory Group

EFRAG Update

January 2014

Summary of EFRAG Technical Expert Group (TEG) meeting January 2014

EFRAG TEG held a conference call on 7 January 2014 to approve a draft comment letter on the IASB Exposure Draft *Equity Method in Separate Financial Statements – Proposed amendments to IAS 27*, to approve the EFRAG Short Discussion Series paper *The Equity Method: measurement basis or one-line consolidation?* and to approve a draft comment letter on the IASB Exposure Draft *Annual Improvements to IFRSs 2012–2014 Cycle*.

From 27-29 January 2014 EFRAG TEG held its monthly meeting. The following topics were discussed:

- IASB Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*
- *Annual Improvements to IFRSs 2010–2012 and 2011–2013 Cycles*
- IASB Narrow Scope Amendment *Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)*
- IFRS 3 Business Combinations – Subsequent accounting for acquisition step-ups
- Long-Term Investment Business Models
- IASB Project *Accounting for Macro Hedging*
- IASB Project *IFRS 9 Financial Instruments - Impairment*
- IFRS 11 *Joint Arrangements*
- IASB Post-implementation Review *IFRS 3 Business Combinations*
- IASB Exposure Draft *Equity Method: Share of Other Net Asset Changes - Proposed amendments to IAS 28*

Highlights

Comment letters

EFRAG published its comment letter on the IASB Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* on 3 February 2014. For more details please see page 2.

EFRAG published its draft comment letter on the IASB Exposure Draft *Annual Improvements to IFRSs 2012–2014 Cycle* on 8 January 2014. For more details, please see page 2.

Short Discussion Series

EFRAG published the first paper in EFRAG's new *Short Discussion Series* on 17 January 2014. For more details about the EFRAG Short Discussion Series paper *The Equity Method: measurement basis or one-line consolidation?* please see page 2.

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Endorsement advices

EFRAG published its draft endorsement advices on the *Annual Improvements to IFRSs 2010–2012 and 2011–2013 Cycles* on 31 January 2014. For more details please see page 4.

EFRAG published its endorsement advice on the IASB Narrow Scope Amendment *Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)* on 30 January 2014. For more details please see page 4.

IASB Exposure Draft *Equity Method in Separate Financial Statements – Proposed amendments to IAS 27*

On a conference call on 7 January 2014, EFRAG TEG discussed and approved a revised version of a draft comment letter on the Exposure Draft.

In its draft comment letter, EFRAG welcomes the proposed amendments to allow the use of the equity method to account for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements.

The letter further explains that although EFRAG is generally not in favour of introducing accounting policy options in IFRS, as they reduce the comparability of financial information, in this case the reduction in comparability is outweighed by benefits.

The letter also suggests that the IASB should take this opportunity to better clarify the objective of separate financial statements.

EFRAG Short Discussion Series paper *The Equity Method: measurement basis or one-line consolidation?*

On a conference call on 7 January 2014, EFRAG TEG approved the paper which is the first publication in EFRAG's Short Discussion Series.

This paper looks at the history of the equity method in IAS 28 *Investments in Associates and Joint Ventures*. It considers to what extent the equity method in IAS 28 is a measurement basis, a one-line consolidation or whether it perhaps has characteristics of both.

A better articulation and understanding of what the equity method aims to achieve is necessary to assist consistent application in practice while avoiding the development of ad hoc narrow scope guidance. The latter would move IFRS away from a principles-based set of standards. Clarity about the principles underlying the equity method could affect the way the IASB further develops it in the future. The paper intends to assist the IASB in its work and to stimulate debate in Europe and beyond.

IASB Exposure Draft *Annual Improvements to IFRSs 2012-2014 Cycle*

On a conference call on 7 January 2014, EFRAG TEG approved a draft comment letter in relation to the Exposure Draft.

In its draft comment letter, EFRAG agrees with most proposals but expresses concern about the proposed amendments to IAS 19 *Employee Benefits*.

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

At its January 2014 meeting, EFRAG finalised its comment letter on the IASB Discussion Paper. EFRAG welcomes the IASB's project on improving its Conceptual Framework. European constituents, including EFRAG, have over the years repeatedly called for this revision to take place. EFRAG therefore agrees with the high priority the IASB has given to this project and with the aim of completing the project within a few years. EFRAG appreciates the work that the IASB has done in analysing areas that have proven problematic in the past and supports the practical approach taken in the project.

EFRAG's comment letter provides responses to the Discussion Paper, which include:

Amendments to Chapters 1 and 3 of the existing Conceptual Framework

EFRAG disagrees with the approach not to reconsider Chapters 1 and 3 of the existing Conceptual Framework. EFRAG believes that the objective of assessing stewardship needs to be presented as a separate objective in Chapter 1; that reliability should replace 'faithful representation'; and that prudence should be reintroduced and explained.

The role of the business model in financial reporting

EFRAG agrees with the IASB's preliminary view that financial statements can be made more relevant if the IASB considers how an entity conducts its business activities. Similarly, EFRAG agrees that measurement should be based on how assets contribute to future cash flows and how liabilities will be settled or fulfilled, as this forms a sound basis for reflecting an entity's business model.

A definition/description of profit or loss

EFRAG thinks the Conceptual Framework should provide a definition/description of what profit or loss should depict so that it can play its role as the primary performance metric. EFRAG believes further work is necessary on recycling and distinguishing between profit or loss and other comprehensive income.

Elements of financial statements and recognition

EFRAG generally agrees with the proposed new definitions of the elements of financial statements, however recommends that the IASB tests possible interpretations to ensure that the definitions will be interpreted in a consistent manner. We believe that the proposed definition of constructive obligations is too narrow and that the proposed definition of assets may result in more assets being recognised than under some interpretations of the current definition. ERFRAG recommends that probability thresholds for recognition should be considered on a standards level and that Conceptual Framework should provide guidance in that regard.

Distinction between liability and equity elements

EFRAG supports addressing the distinction between liabilities and equity instruments at the conceptual level. We also support the definition of equity as a residual. However, EFRAG does not support the strict obligation approach or the narrow equity approach described in the Discussion Paper as they both have significant problems that have not been adequately investigated.

Disclosure

EFRAG agrees with the direction of the proposals on disclosure but thinks that the Conceptual Framework could go further than proposed to provide guidance on how to 'provide a structured way to review the need for disclosure'. This may help preparers understand the rationale behind disclosure requirements and hence guide them in their application; it may also introduce discipline in relation to the IASB's standard setting.

Implications on existing Standards of amending the Conceptual Framework

Although the revised Conceptual Framework will not have any direct impact on existing Standards, EFRAG thinks that it would be useful if the forthcoming Exposure Draft were to list conflicts between aspects of the proposed revised Conceptual Framework and existing Standards. This would enable the IASB's constituents to better assess the possible long-run impact of the revised Conceptual Framework. We believe that the IASB should explain how these conflicts should be taken into account both when interpreting existing Standards and when assessing required accounting treatments in the absence of specific guidance (or a Standard dealing with similar and related issues).

General points

EFRAG also thinks that the IASB should not limit parts of the Conceptual Framework for the IASB's use only.

Annual Improvements to IFRSs 2010-2012 and 2011-2013 Cycles

At its January 2014 meeting, EFRAG TEG approved two invitations to comment relating to the endorsement of the *Annual Improvements to IFRSs 2010–2012 and Annual Improvements to IFRSs 2011–2013* for use in the European Union and European Economic Area.

EFRAG's initial assessment is that the amendments satisfy the technical criteria for endorsement and EFRAG should therefore recommend their endorsement.

Comments are requested by 3 March 2014.

IASB Narrow Scope Amendment *Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)*

At its January 2014 meeting, EFRAG TEG approved an endorsement advice on the amendment *Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)* for use in the European Union and European Economic Area.

EFRAG's assessment is that the amendment satisfies the technical criteria for endorsement and therefore recommends endorsement.

IFRS 3 *Business Combinations* – Subsequent accounting for acquisition step-ups

At its January 2014 meeting, EFRAG staff presented a paper on an issue raised by some users in relation to IFRS 3 *Business Combinations*.

The paper discussed alternative ways to present the reversal of acquisition step-ups (fair value adjustments on acquisition), when assets that were acquired in a business combination are subsequently sold. It is argued that the step-ups impair a reader's ability to understand how the acquired business will contribute to the reporting entity's performance on a continuing basis.

In general, EFRAG TEG members recommended that the analysis of the issue should be broadened and placed in the more general context of the post-implementation review of IFRS 3. They also suggested that if EFRAG was going to release a series of papers on IFRS 3 issues, it would be useful to inform constituents ahead of the contents of the series.

Long-Term Investment Business Models

At its January 2014 meeting, EFRAG TEG members continued their discussions on an impairment model for financial assets used in the context of a long-term business model.

EFRAG TEG members discussed whether such impairment model could be based on a dividend discount model, like that developed by The European Federation of Financial Analysts Societies (EFFAS).

Most EFRAG TEG members did not support the dividend discount model. Many members were in favour of a previously agreed impairment model based on the lower of cost and market value.

EFRAG TEG members considered supplementary letters (to the 25 October 2013 letters) to the IASB and the European Commission with recommendations on an impairment model for financial assets used in the context of a long-term business model; and the conclusions reached on an 'asset-driven business model'. These letters will be finalised on the 7 February 2014 EFRAG TEG conference call.

IASB Project *Accounting for Macro Hedging*

At its January 2014 meeting, EFRAG TEG discussed a number of essential characteristics of a future macro hedge accounting model.

In order to be able to assess the different characteristics, EFRAG TEG members asked EFRAG staff to prepare an analysis of interest rate risk management based upon practical examples. The purpose of the analysis would be to understand the profit or loss effects of different accounting choices. Additionally, a comparison of the revaluation approach with other macro hedge accounting models was requested. EFRAG staff was asked to develop an analysis of whether swaps could be accounted for at fair value through other comprehensive income.

IASB Project *IFRS 9 Financial Instruments - Impairment*

At its January 2014 meeting, EFRAG TEG received an update of the recent FASB decisions regarding impairment and classification and measurement.

EFRAG TEG members reaffirmed their lack of support for the FASB full lifetime expected credit loss model, as it results in excessive front-loading of credit losses and double counting of losses. The FASB approach also provides less relevant information on credit deterioration.

EFRAG TEG members took note of the FASB decision to abandon the 'solely payment of principal and interest' criterion and to retain the bifurcation for financial assets based upon the 'closely related' criterion.

IFRS 11 *Joint Arrangements*

At its January 2014 meeting, EFRAG TEG discussed a possible letter to the IASB concerning accounting in separate financial statements for interests in joint operations structured through a separate vehicle. This letter is intended to bring formal support to the OIC's request to have an option in accounting for joint ventures in separate financial statements giving greater weight to the legal boundary of the entity. As this issue has impacts for European countries other than Italy, this draft letter will be discussed with the EFRAG Consultative Forum of Standard Setters in its meeting at the end of February 2014. This will serve as further due process for EFRAG in this matter.

IASB Post-implementation Review *IFRS 3 Business Combinations*

At its January 2014 meeting, EFRAG TEG members discussed the consultation activities that EFRAG staff will undertake during phase 2 of the Post-implementation Review of IFRS 3 *Business Combinations* to gather evidence for a response to the IASB's forthcoming Request for Information. In accordance with EFRAG's policy, field work will be coordinated with National Standard Setters.

IASB Exposure Draft *Equity Method: Share of Other Net Asset Changes - Proposed amendments to IAS 28*

At its January 2014 meeting, EFRAG TEG discussed the consequences of the IASB decision in December 2013, after having explored various alternatives, to revert to the original Exposure Draft.

The Exposure Draft proposed to amend IAS 28 in relation to the recognition by an investor of 'other net asset changes' – that is changes in the net assets of an investee (accounted for under the equity method) that have not been recognised in profit or loss or other comprehensive income of the investee, and that are not distributions received. The proposed amendments would require other net asset changes to be recognised directly in the equity of the investor, and for the investor to 'recycle' to profit or loss such changes when it ceases to apply the equity method for that investee.

EFRAG TEG advised that, as a result of the lack of support the Exposure Draft received when it was issued, the IASB should explore, before final publication, the consequences of the proposed amendments at the Accounting Standards Advisory Forum.