

April 2013

Summary of EFRAG Technical Expert Group (TEG) and Consultative Forum of Standard Setters (CFSS) meeting April 2013

EFRAG TEG held a conference call on 8 March 2013 to approve EFRAG's draft comment letter on the IASB Exposure Draft *Novation of Derivatives and Continuation of Hedge Accounting: Proposed Amendments to IAS 39 and IFRS 9*.

EFRAG TEG held a conference call on 12 March 2013 to discuss an EFRAG supplementary comment letter on the IASB Review Draft *IFRS 9 Chapter 6: Hedge Accounting*.

EFRAG TEG held a conference call on 21 March 2013. The following topics were discussed:

- IASB Exposure Draft *Recoverable Amount Disclosures for Non-Financial Assets*
- The Conceptual Framework for Financial Reporting
- IASB Review Draft *IFRS 9 Chapter 6: Hedge Accounting*
- IASB Exposure Draft *Financial Instruments: Expected Credit Losses*

From 3 to 5 April 2013 EFRAG TEG held its monthly meeting. The first day was held in conjunction with EFRAG CFSS. The EFRAG CFSS meeting was devoted to preparation for the first meeting of the Accounting Standards Advisory Forum and discussed The Conceptual Framework for Financial Reporting.

The following topics were discussed at the EFRAG TEG meeting:

- The Conceptual Framework for Financial Reporting
- IASB Exposure Draft *Financial Instruments: Expected Credit Losses*
- IASB Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9*
- IASB Exposure Draft *Clarification of Acceptable Methods of Depreciation and Amortisation*
- IASB Exposure Draft *Acquisition of an Interest in a Joint Operation*
- IASB Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*
- IASB Exposure Draft *Equity Method: Share of Other Net Asset Changes*
- IASB Exposure Draft *Novation of Derivatives and Continuation of Hedge Accounting: Proposed Amendments to IAS 39 and IFRS 9*
- EFRAG/OIC Questionnaire *The Subsequent Measurement of Goodwill*
- EFRAG/ANC/FRC Proactive Project *Towards a Disclosure Framework for the Notes*
- IASB Project *Revenue Recognition*
- EFRAG/ANC/FRC Proactive Project *The Role of the Business Model in Financial Reporting*

Highlights

Comment Letters

EFRAG published a supplementary comment letter to the IASB on the impact of IASB Review Draft *IFRS 9 Chapter 6: Hedge Accounting* to current macro hedging practices on 22 March. See page 2 for details.

EFRAG published its comment letter on IASB Exposure Draft *Recoverable Amount Disclosures for Non-Financial Assets* on 25 March. See page 3 for details.

EFRAG published its comment letter on IASB Exposure Draft *Novation of Derivatives and Continuation of Hedge Accounting* on 10 April. See page 2 for details.

EFRAG published its comment letter on IASB Exposure Draft *Clarification of Acceptable Methods of Depreciation and Amortisation* on 10 April. See page 5 for details.

EFRAG published its comment letter on IASB Exposure Draft *Equity Method: Share of Other Net Asset Changes* on 12 April. See page 6 for details.

EFRAG published its comment letter on IASB Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* on 15 April. See page 6 for details.

EFRAG published its comment letter on IASB Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9* on 16 April. See page 4 for details.

EFRAG expects to publish its final comment letter shortly on IASB Exposure Draft *Acquisition of an Interest in a Joint Operation*. See page 5 for details.

IASB Exposure Draft *Novation of Derivatives and Continuation of Hedge Accounting: Proposed Amendments to IAS 39 and IFRS 9*

EFRAG TEG approved a draft comment letter in response to the Exposure Draft in a conference call on 8 March. The draft comment letter was published on 11 March 2013 and the comment period closed 25 March 2013.

At its April meeting EFRAG TEG approved a final comment letter, which welcomed the IASB's responsiveness in providing relief from having to discontinue hedge accounting when entities novate hedging instruments to central counterparties. However, EFRAG believed that the IASB should remove the condition that the novation is required by laws or regulations as it would unnecessarily restrict the scope of the relief. All voluntary novations with a central counterparty should be included in the relief, because the economic impact of a novation to a central counterparty is the same, regardless whether the novation was required by law, done in anticipation of a legal requirement, done to obtain regulatory relief or done on a purely voluntary basis.

EFRAG also noted that diversity in practice exists regarding the interpretation of derecognition requirements as applied to novations, namely that certain novations do not lead to derecognition. Without expressing a view on whether this is an appropriate interpretation, EFRAG noted that the wording of the Exposure Draft would prohibit such an interpretation. Therefore, rather than requiring retrospective application, EFRAG believed the IASB should include an effective date with early application permitted and only require prospective application.

IASB Review Draft *IFRS 9 Chapter 6: Hedge Accounting*

In its conference call on 12 March, EFRAG TEG discussed a draft supplementary comment letter on the impact on current macro hedging practices of the transition between IAS 39 *Financial Instruments: Classification and Measurement* and the proposals in the Review Draft which will become Chapter 6 of IFRS 9 *Financial Instruments*. In its conference call on 21 March, EFRAG TEG approved the supplementary comment letter. The supplementary comment letter identified that some portfolio hedging practices currently allowed under IAS 39 would not be able to continue. This was caused by the IASB decoupling its project on macro hedging for open portfolios from the general hedge accounting requirements. In the supplementary comment letter, EFRAG concluded a straightforward and practical way of ensuring that existing IAS 39 compliant portfolio hedging practices would not be affected by the Review Draft would be to provide entities a simple choice to either (1) retain IAS 39 hedge accounting for all of their hedges until either they decide to apply IFRS 9 irreversibly or the project on macro hedging is completed or (2) to adopt irreversibly the requirements of the Review Draft as drafted.

IASB Exposure Draft *Recoverable Amount Disclosures for Non-Financial Assets*

The Exposure Draft proposed to amend the disclosure requirements in IAS 36 *Impairment of Assets* with regard to the measurement of the recoverable amount of impaired assets. Those disclosure requirements were introduced as a consequence of issuing IFRS 13 *Fair Value Measurement* in May 2011 but the IASB acknowledged that some of the amendments made to IAS 36 had the effect of applying requirements more broadly than the IASB intended.

In its final comment letter, EFRAG agreed with the proposal as it removes burdensome and unintended disclosures requirements without reducing the relevance and understandability of the financial information.

IASB Exposure Draft *Financial Instruments: Expected Credit Losses*

The IASB issued the Exposure Draft *Financial Instruments: Expected Credit Losses* on 7 March; EFRAG TEG discussed an initial draft comment letter in a conference call on 21 March and at its April meeting. The Exposure Draft proposes to eliminate the existing requirement to recognise an impairment loss only after a credit loss event has occurred. Instead, expected credit losses would always be recognised, even if there is not a specific credit loss event, and updated for any changes. Furthermore a dual-measurement approach would require an entity to distinguish between financial assets that have deteriorated and those that have not, and recognise an allowance for 12-month or lifetime expected credit losses depending on the extent of deterioration in the borrower's ability to meet its contractual terms.

EFRAG TEG discussed the main proposals and whether the approach in the Exposure Draft achieves an acceptable balance between the cost of implementation and the underlying economics. EFRAG TEG also considered the FASB's proposed approach of recognising a loss allowance equal to all expected credit losses on initial recognition

EFRAG TEG members discussed whether the IASB's proposed approach, which addresses the calls of the G20 and regulators for earlier recognition of credit losses and having lower implementation costs than the original 2009 proposals, would adequately capture the underlying economics of lending.

The Conceptual Framework for Financial Reporting

In its 21 March conference call, EFRAG TEG approved a bulletin on Prudence. The bulletin was also required to be approved by the standard setters of Germany, United Kingdom, France and Italy before publication.

At its April meeting EFRAG CFSS prepared for the meeting of the IFRS Foundation's Accounting Standards Advisory Forum, the agenda of which included the Conceptual Framework. EFRAG CFSS members had a number of comments they felt should be considered by the European representatives at the ASAF, including that:

- As the scope of the project was limited to financial statements, it was considered necessary that the IASB explain the role of financial statements in the context of financial reporting;
- The consequences of suggested definitions of elements should be illustrated in the discussion paper;
- The approach considered by the IASB in relation to equity solved some issues in relation to the distinction between debt and equity – but not all – and that various perspectives should be considered;
- There should be asymmetry between when assets and liabilities should be recognised (prudence);
- The probability of an inflow or an outflow should be considered before recognising assets and liabilities;
- Initial measurement should generally be based on the transaction price;
- Measurement should seek relevance for both the financial position and the performance of an entity and reflect how an asset or liability is expected to be realised or settled;
- The Conceptual Framework should define what performance is;
- Criteria for determining what should be recognised in Other Comprehensive Income should not be induced from current requirements included in IFRS (but should be based on the purpose of the various statements); and
- The comment period on the IASB's forthcoming Discussion Paper should be six months (and not only four months as currently planned).

The IASB's intention to not include any new thoughts on the reporting entity in the discussion paper was also discussed. EFRAG CFSS members agreed that, if the IASB did not intend to discuss the reporting entity concept further, it should not be part of the Discussion Paper.

Some EFRAG CFSS members thought that the discussion paper should present alternatives to the entity approach rather than including the previous exposure draft and the comments received as an appendix.

At its April meeting, EFRAG TEG discussed draft bulletins on the role of the business model in financial statements and the asset/liability approach. EFRAG TEG members also considered whether a bulletin on complexity should be issued and expressed support for further investigation of this.

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

At its April meeting, EFRAG TEG approved a final comment letter in response to the Exposure Draft. In its comment letter, EFRAG welcomed the IASB's decision to consider making limited amendments to IFRS 9 *Financial Instruments* and appreciated the effort made to consider accounting mismatches arising from the application of different measurement models to financial assets and insurance liabilities. However, EFRAG expressed concern that there were still many financial assets that would not pass the contractual cash flow characteristics test, for a number of reasons, despite the fact that measurement other than fair value through profit or loss (FV-PL) would provide more useful information. EFRAG also believed the IASB should clarify that the

definition of interest in IFRS 9 (and the related application guidance) are not meant to be inconsistent with how entities determine interest of financial assets in practice, for example including a reasonable profit margin and a premium for liquidity risk and considering other entity-specific factors such as the expected future behaviour of customers, provided that the resulting interest reflects market transactions. In addition, EFRAG recommended the IASB introduce bifurcation into IFRS 9 for financial assets based on an approach consistent with the contractual cash flow characteristics assessment, as described in paragraphs BC63-BC66 of the Exposure Draft, unless the entity elects the fair value option to avoid excessive costs caused by bifurcation, at either the entity- or portfolio-level.

With regards to the introduction of a third business model in IFRS 9, EFRAG believed that the Exposure Draft failed to clearly identify the business model underlying measurement at fair value through Other Comprehensive Income (FV-OCI). In addition, it did not fully address the concerns raised by insurance companies, which was one of the reasons for reopening the classification and measurement requirements in IFRS 9. EFRAG believed that measurement at FV-OCI is necessary as part of a solution to address insurers' concerns about accounting mismatches and performance reporting. Therefore, EFRAG recommended the IASB to introduce FV-OCI measurement as part of its project on insurance contracts.

IASB Exposure Draft *Clarification of Acceptable Methods of Depreciation and Amortisation*

At its April meeting EFRAG TEG approved a final comment letter on the Exposure Draft.

In its final comment letter, EFRAG supported the IASB's efforts to clarify the current requirements regarding the use of revenue-based methods of depreciation and amortisation.

However, EFRAG believed that the IASB should remove any language from the exposure draft that discourages entities from applying revenue-based methods when they represent an appropriate proxy for reflecting the depreciation of the asset through its use.

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

At its April meeting EFRAG TEG discussed and approved a final comment letter on the Exposure Draft. The Exposure Draft proposed amendments to IFRS 11 *Joint Arrangements* so that a joint operator should apply the relevant principles for business combinations accounting in IFRS 3 *Business Combinations* and other relevant IFRS when accounting for such acquisitions. Neither IFRS 11 nor IAS 31 *Interests in Joint Ventures* explicitly address this type of transaction.

In its final comment letter, EFRAG supported the objective of the ED and the IASB's efforts to address the issue. However, EFRAG identified several significant concerns with the application of the principles in IFRS 3 to the acquisition of an interest in a joint operation. In EFRAG's view, the ED addressed the issue by focusing on a narrow set of circumstances and failed to address a number of important related issues. EFRAG expressed concern that this might result in new uncertainty in accounting and prolong the diversity in practice. Given these concerns, EFRAG did not support the proposed amendments

In EFRAG's view a more comprehensive analysis of accounting for acquisitions of an interest in a joint operation would be required to achieve consistent accounting for acquisitions of joint operations and related transactions. Furthermore, the IASB needed to explore the interaction of the Exposure Draft with existing related requirements in IFRS and other amendments being developed concurrently by the IASB before finalising the Exposure Draft.

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

At its April meeting EFRAG TEG approved a final comment letter on the Exposure Draft, which was issued by the IASB in December 2012. The Exposure Draft is intended to address the acknowledged inconsistency between the requirements in IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures (2011)*, in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or a joint venture.

In the final comment letter EFRAG agreed that there was an inconsistency between IFRS 10 and IAS 28 and considered that the amendments had the merit of being a short-term pragmatic solution to address diversity in practice.

However, EFRAG was concerned that the Exposure Draft would require an entity to determine whether the asset being sold or contributed meets the definition of a business under IFRS 3 *Business Combinations*. Applying the definition of a business in IFRS 3 often requires considerable judgement and the proposed approach puts considerable stress on the definition of a business.

EFRAG was also concerned that the Exposure Draft might raise a number of other issues within IFRS 10 and IAS 28, which are explained in the letter.

Finally, EFRAG also believed that the IASB should address in the Exposure Draft the accounting treatment in separate financial statements, sales or contributions to joint operations and the reclassification of gains or losses previously recognised in other comprehensive income.

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

At its April meeting EFRAG TEG approved a final comment letter on the Exposure Draft.

The Exposure Draft proposed to amend IAS 28 *Investments in Associates and Joint Ventures* on the recognition by an investor of 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 ('other net asset changes'). 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.

In its final comment letter EFRAG agreed that diversity in practice exists on how an investor recognises its share of other net asset changes of an investee, and therefore supported the IASB's efforts to address the issue. However, EFRAG believed that the approach proposed by the IASB would present certain transactions between an investee and third parties as if they were transactions with the investor's owners. This would lead to an inconsistency with the presentation requirements in IAS 1 *Presentation of Financial Statements*, which requires an entity to present all non-owner changes in equity within comprehensive income.

EFRAG also believed that there was no conceptual basis to 'recycle' to profit or loss other net asset changes, especially given that the proposed amendments start from the premise that other net asset changes should be treated in the same way as transactions with owners.

In EFRAG's view, a short-term solution should not introduce a fundamentally new approach and should not create inconsistencies with existing IFRS. EFRAG therefore disagreed with the proposed amendments.

Instead, EFRAG recommended the IASB undertake further work on the conceptual basis of the equity method (i.e. whether it is considered a 'one-line consolidation' or a measurement basis) in order to address the accounting for the various types of transactions that result in other net asset changes.

EFRAG/OIC Questionnaire *The Subsequent Measurement of Goodwill*

At its April 2013 meeting, EFRAG TEG approved a feedback statement of the responses to the questionnaire on goodwill impairment and amortisation prepared by the OIC and EFRAG staff. The results of the questionnaire show that there are many different views on how to account for goodwill.

EFRAG/ANC/FRC Proactive Project *Towards a Disclosure Framework for the Notes*

At its April 2013 meeting, EFRAG TEG approved a joint feedback statement on the Discussion Paper prepared by the staffs of EFRAG, the ANC and the FRC.

The joint feedback statement highlighted the main messages received from constituents, who largely supported the need for actions to ensure that notes provide all relevant information without being cluttered by irrelevant disclosures; however views differed on how to achieve this objective.

The FASB had also received feedback on its own Discussion Paper. The EFRAG and FASB staffs would jointly present feedback received at the next meeting of the International Forum of Accounting Standard-Setters.

IASB Project *Revenue Recognition*

At its April 2013 meeting, EFRAG TEG received a presentation of the issues of telecommunication companies in relation to applying the forthcoming requirements on revenue recognition.

EFRAG TEG members also considered the latest developments on the project.

EFRAG/ANC/FRC Proactive Project *The Role of the Business Model in Financial Reporting*

EFRAG TEG discussed the status of the project and considered a draft bulletin on the *Role of the Business Model in Financial Statements*. The bulletin, part of a series being published by EFRAG and National Standard Setters, is expected to be published in advance of the Discussion Paper. EFRAG TEG intends to finalise its discussions at its May meeting.