

September 2008

Summary of the EFRAG meetings in September 2008

On Monday 8 and Tuesday 9 September EFRAG TEG (EFRAG) held its monthly meeting and discussed:

- IFRIC 16 Hedges of a Net Investment in a Foreign Operation
- Amendment to IAS 39 Eligible Hedged Items
- IASB project on Consolidations
- IASB ED on Annual Improvements
- CESR draft statement on Fair Value measurement and related disclosures
- IASB ED on Earnings per Share
- PAAinE Discussion Paper on Performance Reporting
- IASB-FASB Convergence projects

IFRIC 16 Hedges of a Net Investment in a Foreign Operation

EFRAG considered IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*. IFRIC 16 clarifies various aspects of IAS 21 and IAS 39. It focuses in particular on:

- When an entity has a presentation currency that is different from its functional currency, do the foreign exchange differences that arise represent a hedgeable risk?
- When there are immediate, intermediate and ultimate parent entities, which exchange rates represent hedgeable risks?
- Does it matter, for hedge accounting purposes, which entity is holding the hedging instrument being used to hedge a net investment in a foreign operation?
- What amounts should be reclassified from OCI to profit or loss as reclassification adjustments on disposal of the foreign operation?

EFRAG discussed its initial technical assessment of IFRIC16 against the criteria for endorsement in the EU. It also discussed its initial assessment of the costs and benefits that would arise from implementation of the Interpretation in the EU. EFRAG's initial assessment is that the Interpretation meets the criteria for EU endorsement and that the benefits that will arise from its implementation in the EU are likely to exceed the costs incurred in implementing it.

EFRAG will issue an Invitation to Comment on its initial assessment in mid-September.

Amendment to IAS 39 Eligible Hedged Items

The Amendment to IAS 39 *Eligible Hedged Items* clarifies when inflation can be designated as a hedged item and how hedge accounting can be applied to hedges where a hedging instrument is an option contract. In particular, the amendment: →

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- clarifies that inflation can only be designated as a hedged item if inflation is a contractually specified component and does not affect other cash flows in the instrument. An example where it is possible to designate the inflation portion as a hedged item would be an inflation-indexed bond. On the other hand, entities are not allowed to designate the inflation portion as a hedged item in a fixed rate instrument.
- states that, if a forecast transaction is hedged with an option contract, it is inappropriate to consider that the hedged forecast transaction contains a time value element equivalent to the time value of an option contract.

EFRAG has been carrying out its technical assessment of the Amendment to IAS 39 *Eligible Hedged Items* against the endorsement criteria and has also been assessing the costs and benefits that would arise from its implementation in the EU.

EFRAG's initial assessment is that both clarifications satisfy the criteria for EU. EFRAG therefore concluded that it should recommend endorsement of the amendment. EFRAG has also tentatively concluded that benefits arising from the amendment are likely to outweigh the costs involved.

EFRAG will issue an Invitation to Comment on its initial assessments of the amendment shortly.

IASB project on Consolidations

On 17 September the IASB held a roundtable discussion in London on a staff draft of an exposure draft of a revised IFRS on consolidations. EFRAG has been invited to participate in the roundtable discussion, so at its September meeting it had a discussion of an early version of the papers to be presented at the roundtable meeting.

EFRAG noted that the objectives of the revision were:

- to bring IAS 27 and SIC 12 together in a single standard;
- to clarify and improve aspects of the existing material.
- to enhance the existing disclosure requirements, with particular regard to entities that were 'nearly' consolidated.

EFRAG members broadly supported these objectives, although they thought the purpose of enhancing the disclosure requirements needed to be clarified: was it to enable users to consolidate entities not consolidated, or was it to provide information about off-balance sheet risk. EFRAG members noted that the project was being accelerated because it dealt with a number of credit crunch-related issues. They supported this approach, although they were not convinced that all aspects of the project needed to be accelerated in this way—or would even benefit from being 'rushed'. On a more detailed level, EFRAG members had concerns about:

- whether some of the new definitions and notions in the draft ED were sufficiently clear to enable them to be consistently applied; and
- whether the disclosures proposed were appropriate and, for example, not too voluminous.

After the roundtable, EFRAG will continue to monitor this project closely.

IASB ED on Annual Improvements

Changes to IFRS, however small, are time-consuming and burdensome for all those with an interest in the standard-setting process. With the intention of easing the burden for all concerned, the IASB has developed an annual process for dealing with non-urgent but necessary amendments to IFRSs (called the 'annual improvements project'). It recently issued its latest exposure draft of annual improvements and, at its September meeting, EFRAG discussed the proposed amendments in order to develop a draft comment letter on the ED. EFRAG members generally supported the proposals, because they provided clarity that was needed, although they had concerns about a few of the proposals. Although EFRAG will need another discussion to finalise its draft comment letter, it is expected that the draft letter will be issued on EFRAG's website around the end of the month.

CESR draft statement Fair value measurement and related disclosures of financial instruments in illiquid markets

EFRAG discussed CESR's draft statement *Fair value measurement and related disclosures of financial instruments in illiquid markets* in order to decide whether to comment on it and, if so, what those comments should be. The draft Statement has been developed by CESR in response to the recent market turmoil to preparers and auditors and to provide input to the IASB's own work on the subject. In the draft Statement CESR sets out some possible guidance on how to distinguish between active and inactive markets, on what factors to take into account when measuring financial instruments in illiquid markets, and on the disclosures needed to enable users to understand fully the entity's financial position.

EFRAG decided that it should comment on the draft, even though this would mean, because of CESR's comment deadline, that it could not follow its normal due process.

EFRAG members were concerned about CESR's positioning of the statement; in their view it would be better to position it just as input to the IASB. That apart, EFRAG members were broadly supportive of what the draft Statement said and thought it would provide useful and insightful input to the IASB's work.

IASB ED on *Earnings per Share*

EFRAG discussed the ED on a revised IAS 33 *Simplification of Earnings per Share* which has been issued by the IASB in August. The objective of the discussion was to develop comments for inclusion in a draft comment letter. EFRAG members broadly supported the proposed amendments and agreed that they make the computation of EPS in some cases more logical. However, not all EFRAG members were convinced by the proposal to introduce the so-called fair value method, under which instruments that can be settled in cash or shares and are classified as a liability and are measured at fair value through profit or loss should be excluded from the computation of diluted EPS. Some were concerned that it might have a negative impact on the decision-usefulness of the information for users. Some agree that users would in practice need to make estimates of the expected value changes for that period or estimate a forecast value change for the following period, others agreed from a measurement perspective but thought additional disclosures would be necessary. EFRAG intends to discuss the matter further with the user community.

EFRAG members also had concerns about the implication for this project of the joint FASB/IASB project on distinguishing between equity and liabilities, with some believing that the timing of the two projects needed to be brought into line.

EFRAG will need another discussion before finalising its draft comment letter. The draft letter is expected to be issued on EFRAG's website around the end of the month.

PAAinE Discussion Paper on Performance Reporting

EFRAG is carrying out together with the Spanish standard-setter a research project on Performance Reporting. This work is being carried out as part of the PAAinE (Proactive Accounting Activities in Europe) initiative, which involves EFRAG and the National Standard-setters in Europe working together on issues of importance to Europe to encourage debate within Europe and to develop European thinking.

A first paper on performance reporting (What (if anything) is wrong with the good old income statement?) was issued in November 2006. That paper highlighted the main comments that are often made for and against the current performance reporting model and analysed those comments to identify the issues underlying the comments—and in particular the issues underlying the difference of view as to whether the current model is in need of fundamental change.

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The main issues identified included:

- What does 'performance' mean?
- Is there a need for bottom lines that mean something, and is there a need for key line(s)?
- Bearing in mind the answers to those questions, what disaggregation models might be suitable and are capable of being effectively implemented?
- Is recycling needed?

EFRAG and the Spanish standard-setter are now working on a second paper which seeks to discuss those issues. This paper is now nearing completion, and at its September meeting EFRAG discussed aspects of the paper and offered suggestions as to how it might be improved.

IASB-FASB Convergence projects

Every six months, an EFRAG delegation (comprising representatives of EFRAG and of the standard-setters of France, Germany and the UK) meet with representatives of the IASB to discuss the IASB/FASB convergence projects. The next meeting will take place on 13 October. During its September meeting EFRAG had an initial discussion as to what the agenda for the meeting might be.



Future meetings

The next meeting of EFRAG TEG will take place on 9 and 10 October 2008. Conference calls are scheduled for 26 September and 3 October. The next CFSS meeting takes place on 8 October 2008.