

July 2009

## Summary of EFRAG meetings held in July 2009

From Wednesday 8 to Friday 10 July 2009 EFRAG held its monthly meeting and discussed:

- IASB Request for Information *Impairment of Financial Assets: Expected Cash Flow Approach*
- IASB Exposure Draft *Financial Instruments: Classification and Measurement*
- IASB Discussion Paper *Credit Risk in Liability Measurement*
- IASB Exposure Draft *Fair Value Measurement*
- IASB Exposure Draft of proposed amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement*
- Amendments to IFRS 2 *Group Cash-settled Share-based Payment Transactions*
- IASB Discussion Paper *Revenue Recognition in Contracts with Customers*
- European Proactive project on the IASB's work on the Definition of an Asset

From Wednesday 15 to Thursday 16 2009 EFRAG held an additional meeting and discussed:

- IASB Discussion Paper *Leases*
- IASB Request for Information *Impairment of Financial Assets: Expected Cash Flow Approach*
- IASB Exposure Draft *Financial Instruments: Classification and Measurement*
- IASB Exposure Draft *Derecognition*
- IASB Exposure Draft *Fair Value Measurement*

## IASB Request for Information *Impairment of Financial Assets: Expected Cash Flow Approach*

At both its meetings in July, EFRAG discussed the IASB's Request for Information *Impairment of Financial Assets: Expected Cash Flow Approach*, which seeks information on the feasibility of implementing an expected cash flow approach to impairment of financial assets. After the second meeting, EFRAG issued for comment its draft response to the request. That draft explains that:

- EFRAG tentatively supports the IASB's decision to review the incurred loss model in the context of other impairment approaches. EFRAG has some concerns about the existing incurred loss model approach, and believes that an expected cash flow approach could address most of those concerns and might perhaps also better represent the economics of income generated over the life of a financial asset held at amortised cost.

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- EFRAG's initial view is that implementation of an expected cash flow approach will involve significant operational challenges in Europe, but could also result in significant potential benefits. EFRAG therefore supports the IASB's decision to seek input on the feasibility of an expected cash flow approach at an early stage.

## IASB Exposure Draft *Financial Instruments: Classification and Measurement*

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In July the IASB issued an exposure draft *Financial Instruments: Classification and Measurement* that proposes new requirements for the classification and measurement of financial assets and financial liabilities to replace the existing requirements in IAS 39 *Financial Instruments: Recognition and Measurement*. Broadly speaking, the proposal is that a financial asset or financial liability should be measured at fair value unless it both has basic loan features and is managed on a contractual yield basis, in which case it can be measured at amortised cost.

Following its discussions in July, EFRAG issued a draft comment letter on the ED. That draft letter explains that EFRAG's tentative views are that it:

- supports the ED's proposal that the new approach should, like IAS 39, be based on a mixed measurement model; and
- is broadly supportive of how the ED is proposing to determine whether a financial instrument should be measured at fair value or amortised cost, although it believes that the proposed boundary is not quite in the right place and in any case is not in all cases clearly drawn. In particular, EFRAG has raised concerns about the treatment of hybrid instruments, investments in securitisations, the prohibition on reclassifying instruments between categories and the transition provisions.

## IASB Discussion Paper *Credit Risk in Liability Measurement*

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In June 2009, the IASB published an invitation to comment on a staff paper *Credit Risk in Liability Measurement*. The paper outlines the three most often-cited arguments in favour of and against including credit risk in current measurement of liabilities. The objective of the invitation to comment is to generate a focused discussion that will enhance the debate on this topic.

During its July meeting, EFRAG finalised its draft comment letter on the paper. In that draft letter EFRAG explains that its view is that the key issue is what approach would result in the most useful information. Applying this test, EFRAG tentatively concluded that consistency between different instruments and between initial measurement and subsequent measurement is not particularly important. It also tentatively concluded that:

- own credit risk should be taken into account in the initial measurement of a liability only if own credit risk is priced into the transaction that gives rise to initial recognition. In all other circumstances it should not be included; and
- changes in own credit risk should not generally be taken into account in subsequent measurements of liabilities.

EFRAG's draft comment letter has now been issued for comment and is available from EFRAG's website.

## IASB Exposure Draft *Fair Value Measurement*

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EFRAG discussed the IASB's ED *Fair Value Measurement* at its first July meeting and continued its discussion at its second July meeting. The purpose of the sessions was to develop a draft comment letter. The ED proposes a definition of fair value based on a market-participant based exit price and guidance for estimating that value. The ED would also introduce new disclosures for fair value measurements. EFRAG's draft comment letter, which is now available on EFRAG's website, explains that EFRAG is generally supportive of the fair value measurement framework described in the ED in so far as it is applied to financial assets and (with the exception of own credit risk) financial liabilities. However, EFRAG does not support the application of fair value as defined and described in this ED to non-financial items.

## IASB Exposure Draft of proposed amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement*

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In July, EFRAG discussed the IASB's ED of proposed amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement*. The proposed amendments would change the accounting for certain prepayments of a pension scheme's minimum funding requirement. EFRAG tentatively supports the clarification in the ED. EFRAG's draft comment letter is now available on EFRAG's website.

## Amendment to IFRS 2 *Group Cash-settled Share-based Payment Transactions*

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The Amendments to IFRS 2 *Group Cash-settled Share-based Payment Transactions* clarify the scope of IFRS 2 and the accounting to be applied for group cash-settled share-based payment transactions in the individual financial statements of the entity receiving the goods or services when the entity does not have the obligation to settle the transaction. In July EFRAG completed its initial assessments of the Amendments against the EU endorsement criteria and in terms of costs and benefits. EFRAG's initial assessment is that the Amendments meet the criteria for endorsement in the EU and that the benefits that are expected to arise from their implementation are likely to exceed the costs incurred in implementing them. EFRAG has published the draft endorsement advice and draft effects study report on its website for comment.

## IASB Discussion Paper *Revenue Recognition in Contracts with Customers*

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EFRAG also in July considered the comments received in response to EFRAG's draft comment letter on the IASB's Discussion Paper *Revenue Recognition in Contracts with Customers* and, in the light of those comments, finalised its comment letter.

- In its draft letter, EFRAG explained that it has a fundamentally different view as to when revenue should be recognised to the one proposed in the discussion paper. The model suggested in IASB's discussion paper would result in revenue relating to a particular performance obligation being recognised only when that obligation has been satisfied. As a result, revenue related to certain service and construction contracts not being recognised until the contract has been completed. EFRAG does not think this would result in the most useful information. EFRAG believes the financial statements would be most decision-useful were revenue a measure of the activity being carried out to fulfil a contract with a customer. Thus, for a construction contract revenue would be recognised as work progresses. EFRAG's draft letter went on to

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suggest the adoption of a continuous revenue recognition model. Respondents generally agreed with EFRAG's concerns about the implications of the IASB's proposed model for certain service and construction contracts, and EFRAG's final letter continues to raise those concerns. Although most respondents also did not support EFRAG's suggestion that a continuous model should be applied to all transactions, EFRAG has nevertheless decided to retain the continuous model as the basis for revenue recognition. It notes that the continuous model would result in the same pattern of revenue recognition as the existing approach (and the IASB's proposed approach) for many transactions. In a cash sale—for example when a customer buys things in a supermarket—the suggested model would result in revenue being recognised in the same way as currently, because the time span of the transaction is so short. Also, EFRAG thinks that for pragmatic—principally cost-benefit—reasons it might be necessary to operationalise the principle differently for different types of transactions.

- However, putting that fundamental concern aside and focusing on the model proposed, EFRAG tentatively agreed in its draft letter with much of what the IASB Discussion Paper proposed, and that support has been carried forward into the final letter.

## European Proactive project on the IASB's work on the Definition of an Asset

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As part of the joint IASB and FASB project on the Conceptual Framework, the boards have been discussing a possible new definition of 'an asset'. In order to understand better the implications of the new definition the two boards have developed, EFRAG and the European National Standard-setters decided to test the existing and possible new definition against a range of transactions. At its first July meeting, EFRAG discussed a draft paper on the results of that work. The paper suggests that the possible new definition seems to address some of the uncertainties that exist with the existing definition, but might create some new uncertainties. It was also noted that under the possible new definition there would probably be more assets than under the existing definition, which would to some extent shift the focus onto the recognition criteria, if any.

As it is understood that the IASB and FASB are re-assessing their own work in this area, a decision on whether (and if so how) to publish the results of the European work was deferred until the autumn.

## IASB Discussion Paper *Leases*

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In July, EFRAG also considered the comments received in response to EFRAG's draft comment letter on the IASB Discussion Paper *Leases* and, in the light of those comments, finalised its comment letter. EFRAG's view of the paper can be summarised as follows:

- EFRAG believes definitive conclusions should not be reached on the direction and key principles underlying a new lease accounting model until the issues have been analysed from the perspective of both lessees and lessors.
- Subject to that, EFRAG is inclined towards supporting a 'right-of-use approach' for all lease arrangements. However, EFRAG would be concerned about the cost-benefit implications were such an approach to be applied to short-term lease arrangements. EFRAG also thinks such an approach would also make the distinction between leases and service arrangements even more important than it is currently.
- EFRAG members are divided on the Discussion Paper's proposal that lessees should recognise a single lease asset and a single lease liability that take into account expectations as to how options concerning the lease term are expected to be exercised. Some members would prefer a lease asset and lease liability to be recognised based on minimum lease payments, with options recognised separately.

## IASB Exposure Draft *Derecognition*

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Finally, at its second July meeting EFRAG considered the responses it received to its draft comment letter on the ED *Derecognition* with the objective of finalising EFRAG's comment letter to the IASB. The letters received were broadly supportive of the main messages in EFRAG's draft comment letter, which were that:

- the IASB should focus in the short-term on crisis-related issues and, in the context of derecognition, the crisis-related issue is disclosure;
- the ED proposes some significant changes to the existing derecognition model. EFRAG is not in favour of significant changes being made to the existing model without a more extensive analysis of the issues involved being undertaken first. EFRAG also has a number of fundamental concerns about the changes proposed, and it does not support the proposed treatment of repos; and
- the Alternative Approach described in the ED might be the way forward in the longer term, but it needs to be developed further.

### Future meetings

The next meetings of EFRAG TEG will take place from 1 – 3 September 2009 (this meeting replaces the meeting scheduled for 7 – 9 September 2009) and on 16 September 2009.

A conference call is scheduled for 21 August 2009.

The next CFSS meeting takes place on 7 October 2009.