EFRAG

European Financial Reporting Advisory Group

November

EFRAG Update

Summary of EFRAG meetings held from 30 October to 13 November 2009

On Friday 30 October 2009, EFRAG met to discuss:

- IASB's IFRS 9 *Financial Instruments*

On Friday 6 November, EFRAG held a meeting by public conference call to discuss:

- IASB's IAS 32 amendment *Classification of Rights Issues*

On Wednesday 11 to Friday 13 November 2009, EFRAG held its monthly meeting and discussed:

- IASB Exposure Draft *Financial Instruments: Amortised Cost and Impairment*
- Joint EFRAG/FEE Overview Project on the Expected Loss Model
- IASB Exposure Draft *Improvements to IFRSs*
- IASB Discussion Paper *Extractive Activities*
- IASB's IAS 24 *Related Party Disclosures*
- Consultation on the IFRS 2 *Share-based Payment*
- IASB Exposure Draft on amendment to IAS 1
- IASB Exposure Draft *Derecognition*

IASB's IFRS 9 *Financial Instruments*

At the 30 October meeting, EFRAG members discussed EFRAG's draft endorsement advice and draft effects study report on IFRS 9 *Financial Instruments*. Both arguments against and in favour of a positive endorsement advice were presented. Arguments against endorsement at this stage included the following:

- Subsequent changes to the Standard were very likely due to convergence imperatives or implementation difficulties and these changes were likely to create disruption to the financial reporting of financial instruments. That would compromise understandability and comparability, and generate undue costs for preparers and users.
- The restrictive definition of interest and elimination of bifurcation of embedded derivatives undermined the relevance expected from the mixed measurement approach.
- The elimination of bifurcation of embedded derivatives would result in lack of comparability between financial assets which in substance are similar.
- Because realised gains and losses would not be recycled from other comprehensive income to profit or loss, relevant information about the entity's performance would not be reported.

→

EFRAG iasbl

Square de Meeûs 35
1000 B-BRUSSELS
www.EFRAG.org

→

- Entities could use the option to present fair value changes in a way that would not be in accordance with its business model thus reducing the relevance of the information provided.
- It could result in asymmetrical treatment of financial assets and liabilities. This issue and some of the comparability concerns could be solved if early adoption was not contemplated.

In favour of a positive draft endorsement advice it was argued that:

- The mixed-measurement model would provide relevant information.
- The measurement model, that reflected both the business model and the characteristics of instruments, would produce relevant information.
- The requirement to reclassify financial assets when the business model changed would ensure that entities would continue to report relevant information following such a change.
- The option to report fair value changes on equity securities in other comprehensive income would enable entities to improve the relevance of the provided information.
- Fair value option and hedge accounting would enable entities to eliminate accounting mismatches.
- The clear rationale behind the classification and measurement model and one impairment method for financial assets carried at amortised cost would improve comparability.

Following a vote, EFRAG decided to issue a positive draft endorsement advice letter including two dissenting options and with specific caveats due to the short comment period.

On 12 November, EFRAG posted a news item saying that it had been decided that more time should be taken to consider the output from the IASB project to improve accounting for financial instruments. Therefore, EFRAG would not finalise its endorsement advice on IFRS 9 at this stage.

IFRS Classification of Rights Issues (Amendment to IAS 32)

On 6 November, EFRAG discussed the comments received in response to its draft comment letter on the IFRS *Classification of Rights Issues (Amendment to IAS 32).* The Amendment clarifies that foreign currency rights issues are equity instruments for the purposes of IAS 32 *Financial Instruments: Presentation*. More specifically, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments.

EFRAG's initial assessment was that the Amendment 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. All received comments supported EFRAG's recommendation on endorsement and its evaluation of costs and benefits. As a consequence, EFRAG members voted in favour of finalising the endorsement advice and the effects study report.

IASB Discussion Paper *Extractive Activities*

In August 2009, the IASB published on its website a draft discussion paper on Extractive Activities. EFRAG considered a summary of the proposals and debated certain key issues without taking any tentative decisions. The EFRAG secretariat will continue to develop material based on the feedback from the meeting and will work towards a draft comment letter to be published early in 2010 once the IASB published the final discussion paper.

IASB Exposure Draft Financial Instruments: Amortised Cost and Impairment

At the 11 – 13 November meeting, the IASB staff led a presentation of the Exposure Draft *Financial Instruments: Amortised Cost and Impairment (the ED)*. The ED proposes to clearly set out the objective of amortised cost measurement and how it should be calculated. Impairment of financial assets is an integral component of the amortised cost measurement model. The ED proposes an "expected loss" impairment model where expected credit losses are taken into account in the initial calculation of the effective interest rate and in subsequent estimates of future cash flows. The Proposals would also result in consequential amendments to other IFRSs and to the guidance on those IFRSs.

The proposed standard aims to provide a clear objective, emphasise principles and provide concise application guidance. In addition, certain issues will be discussed with the Impairment Expert Advisory Panel (EAP) rather than being included as guidance in the ED.

EFRAG discussed certain elements of the ED, notably the effective interest rate and expected loss impairment model for financial assets, as well as the practical expedients, but did not reach any tentative conclusions. EFRAG will attempt to finalise its draft comment letter with a technical assessment of the ED as soon as possible, but will consider to concurrently conduct an outreach process to gain insight into the practical and implementation difficulties. It is envisaged that additional views of EFRAG based on the additional input will be published later in the comment period, still allowing sufficient time for responses to be received before a final comment letter is issued to the IASB.

Joint EFRAG/FEE Overview Project on the Expected Loss Model

Also at the 11 – 13 November meeting, EFRAG discussed the draft Joint EFRAG-FEE Paper "Impairment of Financial Assets: The Expected Loss Model' ('the Paper') with a view to approving the paper for publication.

The key amendment since the October EFRAG meeting to the Paper had been to incorporate the proposals of the IASB's Exposure Draft: *Financial Instruments: Amortised Cost and Impairment (the ED)* which was issued on 5 November 2009.

EFRAG voted in favour of approving the paper.

IASB Exposure Draft *Improvements to IFRSs*

EFRAG discussed the comments received from constituents in response to EFRAG's draft comments letter on the IASB exposure draft Improvement to IFRSs. EFRAG members agreed to amend its tentative decisions or include further comments as follows:

- Amendment to *IAS 27 Consolidated and Separate Financial Statements*. As part of the amendment, IASB is proposing to amend IAS 27 that allows an entity that prepares separate financial statements to measure its investments in subsidiaries, jointly controlled entities and associates at cost or fair value through profit or loss *each* in accordance with IAS 39. EFRAG members believed the word 'each' could be interpreted to mean that not only fair value, but also cost should be measured in accordance with IAS 39. EFRAG thought that could lead to an undesirably restricted use of cost, as IAS 39 specifies that cost can only be used if the equity investment is unlisted and it is deemed not possible to 'reliably estimate' fair value. Currently IAS 27 does not specify that cost should be measured in accordance with IAS 39.

→

→

- Amendment to IAS 40 *Investment Property*. EFRAG members did not think the proposed amendment should be dealt with in this Annual Improvement Project. EFRAG members believed the proposed amendment would change current practice and could be assumed to have significant practical implications for some financial statements preparers. Accordingly, EFRAG members consider that it is important for the IASB to fully develop the notion behind the proposal and considers all the effects before suggesting amending the standard.
- Amendment to IAS 1 *Presentation of Financial Statements*. The amendment states that entities are permitted to present the reconciliation requirements for classes of accumulated other comprehensive income either on the face of the statement of changes in equity or in the notes to the financial statements. EFRAG members believed this amendment would dislocate the whole statement of changes in equity to the notes to the financial statements and furthermore would be inconsistent with the IAS 1's requirement related to the content of a complete set of financial statements. EFRAG members also did not support the part of the proposed amendment to eliminate the requirement to disclose dividends.
- Amendment to IAS 28 *Investments in Associates*. EFRAG did not think the proposed amendment specified if the change should be applied prospectively or retrospectively it therefore assumed the amendment should be made retrospectively in accordance with IAS 8. EFRAG members also believed some practical issues would arise as a consequence of the amendment.
- Amendment to IFRIC 13 *Customer Loyalty Programmes*. EFRAG noted that the amendment did not state whether or not the amendment would be applied prospectively or retrospectively. Also, there may be diverging views in practice on whether the amendment would constitute a change in estimate or a change in accounting policy.

EFRAG members approved the final comments letter subject to further drafting changes. The comment letter was issued 20 November 2009.

IAS 24 *Related Party Disclosures*

At its November meeting, EFRAG also agreed to issue for public comment its draft endorsement advice to the European Commission on the IASB's recently issued the Revised IAS 24 *Related Party Disclosures*.

The revised standard set out to simplify the definition of a 'related party' while eliminating some internal inconsistencies, and provide relief for government-related entities in relation to the types of information such entities need to provide in respect of transactions with entities controlled, jointly controlled or significantly influences by the same government.

EFRAG's initial assessment is that the revised standard 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.

Consultation on the IFRS 2 *Share-based Payment*

In November, EFRAG was asked to provide input on the review paper on IFRS 2 prepared by the French standard setter, CNC. The CNC has been required by the IASB to carry out a review of the Standard on share-based payments in order to clarify the underlying accounting principles and provide input to the IASB for a potential future review of the standard.

→

→

EFRAG suggested clarifying the purpose of CNC's review. If the objective was to carry out a fundamental review of IFRS 2, the whole model should be subject to a debate; if the objective was to provide guidance on certain unsolved issues the questions should be more focused and specific.

Also, EFRAG's view was that the objective of the standard should be to recognise the payments made under a share-based award. Accordingly, when there is no payment, no cost should be recognised.

IASB Exposure Draft on amendments to IAS 1

EFRAG discussed the forthcoming IASB Exposure Draft of Proposed Amendments to IAS 1 *Presentation of Financial Statements* (the ED). The ED is expected to be issued as a joint document of the IASB and the FASB in the Q4 2009. The ED is expected to propose eliminating the existing option in IAS 1, which allows entities to present non-owners changes in equity in two statements. The proposal would require entities to present all items of income and expense recognised in a period in a single statement of comprehensive income. However, it is expected that the requirement to display the single statement of comprehensive income in two sections showing profit or loss and other comprehensive income separately would be retained. It is also expected that the subtotal showing net profit for the year from continuous operations will be retained as well.

The views of EFRAG on this issue were split, as some members strongly oppose to the proposal because they believed that in order to maintain the focus of communication between prepares and users on a meaningful measure of performance (i.e., net income) it would be critical that the option to present a separate statement of net income is retained. Another group of members support the proposal as they would result in a greater transparency, consistency and comparability.

Notwithstanding the diverging views, EFRAG agreed that it had strong objection to the IASB's initiative to address this issue in isolation in a separate exposure draft, because it believed that it should be dealt with in the context of the financial statements presentation project once the IASB finalises its discussion on fundamental issues, such as performance, the content of other comprehensive income and recycling.

IASB Exposure Draft *Derecognition*

EFRAG discussed how to respond to an IASB's request for input on the project on derecognition of financial instruments.

After having analysed the responses to the exposure draft (ED) on derecognition issued in March 2009, the IASB is now considering ways forward with this project. In that context, IASB's Chairman asked EFRAG's Chairman to provide feed-back on the options considered by the IASB.

After reaffirming its commitment to abide by its due process in all but exceptional circumstances, EFRAG decided to start working on a draft answer to be issued for comments.

EFRAG then debated about derecognition principles without reaching a consensus. It asked the staff for further analysis and requested input from EFRAG's Financial instruments Working Group.