



EFRAG TEG *UPDATE* MARCH 2007

Summary of the EFRAG TEG and CFSS meetings in March 2007

On Friday 9 March 2007 EFRAG TEG held a one-day meeting to discuss:

- IFRIC 12 *Service Concession Arrangements*
- The PAAinE project on Revenue Recognition
- The IASB ED of Proposed Amendments to IAS 24 Related Party Disclosures:

On Wednesday 14 March EFRAG met with the national standard-setters of Europe in EFRAG's Consultative Forum of Standard-Setters (CFSS) to discuss:

- The IASB's US convergence projects
- The IASB Discussion Paper *Fair Value Measurements*
- The PAAinE project on Revenue Recognition
- The PAAinE project on the Framework

On Wednesday 14 and Thursday 15 March EFRAG TEG also held its regular monthly meeting and discussed:

- The PAAinE project on Equity/liability
 - The convergence discussions with the IASB
 - The IASB project on small and medium-sized entities (SMEs)
 - The IASB project on IFRS 2, Vesting Conditions and Cancellations
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EFRAG TEG meeting on 9 March 2007

At its meeting on 9 March EFRAG considered the comments it received in response to its draft endorsement advice on **IFRIC 12 *Service Concession Arrangements*** in order to finalise and issue that advice. EFRAG members started by discussing the various issues raised by respondents and the implications those issues had for their own views, then moved on to discuss EFRAG's endorsement advice and endorsement advice letter in the light of those implications. EFRAG decided that, although various changes should be made to its draft letter, it should continue to recommend that IFRIC 12 be endorsed for use in the EU. A final endorsement letter is now being prepared and is expected to be issued within the next week. When issued, the letter will be available from EFRAG's website (www.efrag.org).

EFRAG also discussed the **PAAinE project on Revenue Recognition**, and in particular the latest draft of the discussion paper that the staff team prepared. It was explained that the staff team hope it will be possible to issue the paper in April. EFRAG members provided the staff team with comments on the draft, and a revised text will now be prepared.

EFRAG TEG **UPDATE** MARCH 2007

At its meeting on 9 March, EFRAG also discussed **the IASB ED of Proposed Amendments to IAS 24 Related Party Disclosures**. This was EFRAG's second discussion. In February when the main proposals were discussed, EFRAG members generally welcomed and supported the proposals, although they:

- thought that the definition of a related party, though improved, was still difficult to understand and still capable of further improvement;
- had concerns about the proposed changes to the definition of 'close family member'; and
- expressed differing views on the exemption from the disclosure requirements that the IASB was proposing to grant a reporting entity that is a related party of another entity only because both are controlled or significantly influenced by the same state. Some members supported the proposal. Others thought the principle underlying the proposed amendment—that transactions need only be disclosed if the transactions have been affected by the related party relationship—is preferable to that in the existing standard and that therefore the exemption should be extended to all entities.

EFRAG discussed these issues further and agreed that it should suggest to the IASB that the exemption it is proposing to introduce should be extended to all entities. An initial draft comment letter was also discussed and various amendments agreed. It is expected that a revised draft comment letter will be issued on EFRAG's website (www.efrag.org) at the end of the month.

EFRAG CFSS meeting on 14 March 2007

Every six months, an EFRAG delegation meets in public with representatives of the IASB to discuss **the IASB's US convergence projects**. At the CFSS meeting, EFRAG sought input on the issues it should discuss and the messages it should convey at the next meeting in April.

At the EFRAG meeting the next day, EFRAG took some final decisions based on that input (see the summary of that discussion letter in this Update).

EFRAG also explained EFRAG's comment letter on **the IASB Discussion Paper Fair Value Measurements** to the standard-setters. The Discussion Paper is intended to be the first step in the development of an IFRS on the subject. The proposed IFRS would be a 'how to'—rather than 'when to'—fair value standard and as such is not intended in itself to result in an increased use of fair value. The IASB's plan is to define 'fair value'—and that proposed definition treats fair value as a market-based (ie not entity specific) exit value—and then to consider each reference in existing IFRS to 'fair value' to decide whether it is a reference to 'fair value' as defined (as a result of this project) or some other measurement basis.

EFRAG's draft comment letter raises a number of issues about the process being followed, and also expresses concerns about the version of fair value described in the paper—a market-based exit value—being treated as the fair value to which existing IFRS refer. The draft letter also makes a number of detailed comments about the proposals in the paper.

The draft letter is available for comment from EFRAG's website (www.efrag.org).

EFRAG also discussed **the PAAinE project on Revenue Recognition** with the CFSS; in particular the material on the continuous approach. The implications of this approach using various practical examples, was discussed. At the end of the discussion the CFSS agreed that it was content for the paper to be issued as a PAAinE paper when finalised.

Work on finalising the paper will continue.

Finally, the CFSS discussed a proposal developed through the PAAinE project on the Framework. One of the concerns that had been raised in the first PAAinE Discussion paper on the Framework—*The Conceptual Framework: Starting from the right place?* (available from EFRAG's website (www.efrag.org))—was that so little seemed to be known about user information needs. It was therefore proposed that users should be surveyed. The CFSS thought that it was a good idea, and made a number of suggestions as to how the draft survey could be developed further.

EFRAG TEG *UPDATE* MARCH 2007

Work on this project will continue.

EFRAG TEG meeting on 14 and 15 March 2007

For some time now the German standard-setter has been leading a **PAAinE project on Equity/liability**. Many commentators believe that the existing equity/liability classification requirements that are set out in IAS 32 do not work very well and result in instruments that are instinctively thought of as equity being classified as liabilities, and vice versa. The objective of the PAAinE project is therefore to consider possible new approaches to equity/liability classification. A paper is being developed that proposes that capital instruments should be classified as equity if, and to the extent that, they are loss-absorbing, and all other instruments should be classified as liabilities. More work has to be done on exploring the approach even further, but an opportunity has arisen to present the approach to the IASB and, perhaps, for it to be dealt with in an IASB discussion paper that is expected to be issued in the early summer. EFRAG supported the proposal being presented to the IASB in the name of the PAAinE and agreed that the draft paper could be used as an observer note for the session. The PAAinE paper will be presented at the April meeting of the IASB. Work on the PAAinE project will also continue.

As already mentioned, every six months an EFRAG delegation meets in public with representatives of the IASB to discuss **the IASB's US convergence projects**. At its meeting on 14th and 15th March EFRAG considered the input it had received at the CFSS meeting on the issues it should discuss and the messages it should convey at the next meeting in April and agreed that in principle aspects of the following projects should be discussed at the meeting: business combinations, the Conceptual Framework, fair value measurement guidance/Measurement generally, revenue recognition, constructive obligations, equity/liability classification, pensions, and income tax. It was also agreed that the EFRAG delegation should raise certain issues relating to user information needs and should seek advice from the IASB on how Europe might help the IASB in its convergence work. The meeting with the IASB is a public meeting. It will take place in London on 17 April.

EFRAG continued its discussions on the **IASB project on small and medium-sized entities (SMEs)**. EFRAG discussed further the draft comment letter that it has been preparing, and agreed to various amendments. The main messages in the draft are currently as follows:

- The standard should not be called an 'IFRS for SMEs' because it is actually a standard for entities that do not have public accountability, and they could be any size.
- The objective of issuing a stand-alone document should be met without allowing exceptions of either mandatory or optional fallback to full IFRS;
- In order to decide what the form and content the financial statements should take, it is necessary first to have a good understanding of users' information needs. This is important because the users of the financial statements of non-publicly accountable entities are clearly not the same as the users of the financial statements of publicly accountable entities, which means that their information needs are probably different too. This in turn could lead to a different importance being attached to the individual qualitative characteristics, which could result in different pervasive recognition and measurement principles. However, the necessary analysis of user needs is missing from the ED.
- EFRAG believes that greater simplification is needed. It believes, for example, that the financial statements would not be any less useful if all intangible assets were treated as having a finite life and therefore amortised and if a disclosure-only-approach was adopted for equity settled share-based payment transactions.
- EFRAG has included in its draft comment letter some illustrations of how the standard could be restructured, rewritten, rationalized and simplified, while eliminating fallbacks to full IFRS.

EFRAG will finalise and issue its draft comment letter for comment by the end of March 2007.

EFRAG TEG **UPDATE** MARCH 2007

Finally EFRAG had its first discussion on the draft endorsement advice it would issue on the **IASB Amendments to IFRS 2 Share-based payments: Vesting Conditions and Cancellations**. The exposure draft had been issued in February 2006, and the IASB will soon be issuing the final Amendments. EFRAG members noted that some aspects of the final Amendments were similar to the proposals issued in the ED, although the Amendments would provide additional guidance and clarification on matters which had not been specifically addressed in the ED.

The amendments require a cancellation of a share-based payment arrangement by a counterparty, where the counterparty can choose whether to cancel, to be accounted for as a cancellation (ie accelerated vesting). The Amendments also clarify that the impact of non-vesting conditions be taken into account in the initial estimate of fair value at grant date and that failure to meet a non-vesting condition does not affect the vesting of a share-based payment arrangement. Finally, the Amendments address what constitutes a performance condition.

EFRAG members welcomed the guidance provided in the Amendments and generally supported the requirements being put forward, however they expressed differing views on some aspects of the Amendments. In particular:

- Some members thought that the word *vest* is being misused in IFRS 2. They believe that the literal meaning of the word *vest* has a wider and different meaning to the definition as intended by IFRS 2. These members view the Amendments as an opportunity to clarify the meaning of *vest* within the scope of IFRS 2.
- The Amendments clarify that the probability of the entity cancelling a share-based payment arrangement should be assumed to be nil, when estimating the fair value of a grant where the entity has a choice of cancellation. However, it does not address how the probability of cancellation by a counterparty might be considered when determining the fair value of a share-based payment arrangement. EFRAG thought that guidance in this respect would be very helpful.

EFRAG will discuss the Amendments further in April and will then finalise its draft endorsement advice.

EFRAG will hold its next meeting on **25 to 27 April in Copenhagen**.

EFRAG has recently launched its new website (www.efrag.org). Check the site regularly to keep up to date on all EFRAG's activities and for other important news on IFRS.

EFRAG has issued two European Discussion Papers: *The Conceptual Framework: Starting from the right place?* and *What (if anything) is wrong with the good old income statement?* Comments on the papers are invited, by 18 March and 31 March respectively. The papers can be downloaded from EFRAG's website (www.efrag.org).

EFRAG - European Financial Reporting Advisory Group

Avenue des Arts 13-14
Tel. +32 (0)2 210 44 00
info@efrag.org

B-1210 Brussels
Fax. +32 (0)2 210 44 01
www.efrag.org