



Summary of the EFRAG CFSS and TEG meetings in June 2006

On Tuesday 13 June the Technical Expert Group of EFRAG (EFRAG) met with the European National Standard Setters in EFRAG's Consultative Forum of Standard Setters (CFSS). The meeting discussed:

- The IASB's SMEs project
- The PAAinE project on Pensions
- The PAAinE project on the Framework
- EFRAG's draft comment letters on ED 8 and on the amendments to IFRS 2 and IAS 23
- A change to the date of the next meeting.

On Tuesday 13 June and Wednesday 14 June, EFRAG held its monthly meeting and discussed the following topics:

- The draft IFRIC Due Process Handbook
- Business Combinations
- Liabilities
- ED 8 *Operating Segments*
- The ED of proposed amendments to IFRS 2 *Vesting conditions and cancellations*
- The ED of proposed amendments to IAS 23 *Borrowing Costs*
- The PAAinE project on the Framework
- Insurance
- The IFRIC's Service Concessions project.
- Dates for the meetings in 2007

CFSS meeting

Participants at the meeting were provided with an update on **the IASB's SMEs project** and the activities of the joint EFRAG-FEE SME working group, which had met recently with Paul Pacter, the IASB Director of Standards for SMEs, in attendance.

It was noted that the SME standard would not simplify the recognition and measurement requirements of full IFRS in any significant way. Participants thought this was disappointing.

They heard the current proposal was that the IFRSs for SMEs would be a standalone document, although there would be cross-references from the SME standard to sections of full IFRS dealing with certain complex transactions or with options that dealt with in the SME standard. There would also be an option for jurisdictions to include those sections of full IFRS in the SME standard in place of the cross references should they wish. There was some concern as to the effect this cross-referencing (or incorporation of material from full IFRS) would have on the stability of the SME standard, because participants thought that an important aspect of the regime for SMEs should be that their accounting requirements are not continually changing.

It was also noted that the hierarchy to be applied for transactions not specifically covered by the SME standard would differ from the hierarchy in IAS 8 in that the first thing SMEs would be required to do would be to consider the requirements in the SME standard for similar transactions.

EFRAG - TEG **UPDATE** JUNE 2006

In June 2006 EFRAG and the National Standard Setters (NSS) agreed to co-ordinate some of their work on the IASB's agenda so as to enable Europe as a whole to participate more fully in the development of global standards. (We refer to these co-ordinated proactive activities by the acronym 'PAAinE', which stands for 'Proactive Accounting Activities in Europe' or 'PAAinE'.) Four PAAinE projects have now been started, and at the meeting in June participants considered progress reports on two of those projects.

- **The PAAinE project on Pensions** is being led by staff of the UK standard-setter (the ASB), and they gave a presentation to participants on their progress to date. They explained that the project would be looking at all aspects of pension accounting from first principles, with a view to developing a Discussion Paper on the subject. Issues touched on in the presentation and subsequent discussion included:
 - How is the relationship between an employer and a pension scheme best reflected in the employer's financial statements?
 - How should the employer's liability in respect of pensions be quantified? In particular:
 - When should the employer's liability reflect future salary increases?
 - What discount rate should be used to translate future cash flows into a realistic present value?
 - What is 'the expected return on assets', and how (if at all) should it be reflected in the employer's financial statements?
 - What is the impact on financial reporting of pension fund regulation arrangements?
- **The PAAinE project on the Framework** is being led by staff of the French standard-setter (the CNC), and they gave a presentation to participants based on the latest draft of a paper they are preparing. The paper is not intended as a response to the soon-to-be-issued IASB Discussion Paper on the objectives of financial reporting and the qualitative characteristics of financial information. Rather, it focuses on a handful of issues that relate to the Framework but are not necessarily fully addressed in the Discussion Paper. Those issues include:
 - The objective(s) of the conceptual framework, and the implications this has for the framework itself
 - Whether it is appropriate to extend the scope of the framework to include all other types of financial reporting, including press releases that contain financial information, whilst making only minor changes to the concepts themselves (which is what the IASB is likely to propose).
 - Whether the users that frameworks focus on really have similar information needs. For example, are the detailed information needs of potential investors the same as those of existing investors, and are the detailed information needs of short-term investors the same as those of long-term investors? And are the detailed information needs of creditors the same as those of investors?
 - The extent to which financial theory, including notions of capital maintenance, should be reflected in the framework. For example, the notion of capital maintenance is mentioned in the existing framework; should that mention be retained or extended?
 - Whether a single framework was appropriate for all types of reporting entity.

Participants discussed the draft paper and made suggestions as to how it might be improved.

The CFSS was asked for, and provided, input on **EFRAG's draft comment letters on ED 8 and on the amendments to IFRS 2 and IAS 23**. (These letters were finalised later in the meeting—see below.)

The CFSS also agreed to make **a change to the date of the next meeting**: the next meeting, which had been scheduled for 30 August, will now take place on 11 October.

EFRAG meeting

The EFRAG Supervisory Board has decided to prepare a comment letter on **the draft IFRIC Due Process Handbook**. The letter will be issued in draft for public comment before being finalised. As part of this process, EFRAG (ie EFRAG TEG) has been discussing the draft Handbook in order to make suggestions to the Supervisory Board as to the issues it might wish to raise in its letter. A draft paper setting out EFRAG's initial thoughts was discussed. The discussion focused in particular on the composition and working practices of the IFRIC Agenda Committee. The wording that tends to be used to explain an IFRIC decision not to take an issue onto its agenda was also discussed.

The EFRAG Supervisory Board will issue its draft letter for comment on EFRAG's website (www.efrag.org) later in the month.

EFRAG received an update on the decisions taken recently in the joint IASB/FASB projects on **Business Combinations** and on **Liabilities**. EFRAG will continue to follow the debates closely.

The IASB's **ED 8 Operating Segments** proposes to eliminate the current differences between IFRS and US GAAP on segment reporting by in effect issuing the US standard as an IFRS. The main implications of this are that companies would:

- split the activities into the segments used to manage their business; and
- report on the segments identified using measures used internally (and not IFRS measures, if the internal measures are not IFRS measures).

EFRAG issued a draft comment letter which supported the proposal that the segments identified should be those used internally, but argued that IFRS measures rather than internal measures should be used. Some concerns were also expressed about the proposed scope of the revised standard. At its May meeting EFRAG considered the comments received in response to its draft letter. Those responses were divided on whether internal measures or IFRS measures should be used and EFRAG concluded that it should argue for entities to be allowed a choice as to whether to use IFRS measures or internal measures.

At its June meeting EFRAG debated the issue once again and reconfirmed that decision. The final comment letter has since been issued and is available on EFRAG's website (www.efrag.org).

The main proposal in the IASB's **ED of proposed amendments to IFRS 2 Vesting conditions and cancellations** is that cancellations by employees of their participation in a share-based payment arrangement should be accounted for in the same way as cancellations by employers (by immediately expensing the cost that would otherwise have been recognised for that employee over the remainder of the arrangement). In its draft comment letter, EFRAG disagreed with this proposal, arguing that an employee cancellation was not like an employer cancellation and should be accounted for by recognising the expense over the remaining period of the arrangement. At its May meeting EFRAG considered the responses it received to its draft letter and decided that it continued to disagree with the IASB's proposal.

However, at its June meeting EFRAG decided to amend its letter to acknowledge that it can be difficult in some circumstances to differentiate between employee cancellations and employer cancellations. It therefore urges the IASB to give further thought as to how this might be done. It is expected that EFRAG's final comment letter will be issued in the next few days, at which time it will be published on EFRAG's website (www.efrag.org).

At its May meeting EFRAG considered the proposals expected to be in the IASB's **ED of proposed amendments to IAS 23 Borrowing Costs** (which was issued shortly after the meeting). The ED proposes that the option in the existing standard (IAS 23) to expense borrowing costs will be eliminated if those costs are directly attributable to the acquisition, construction or production of a qualifying asset. US GAAP also requires interest cost to be capitalised. EFRAG was not convinced of the merits of this proposal. At its June meeting EFRAG had a further discussion with a view to finalising its draft comment letter.

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One of EFRAG's concerns is that the proposals do not represent much of a step towards convergence; although they mean that IFRS and US GAAP both require capitalisation, the limited scope of the project means that the amount capitalised will differ as will the timing of capitalisation. EFRAG believes that, if changes are to be made in the name of convergence, the amount of convergence achieved needs to be greater than the amount that will be achieved in this case. On the other hand, as far as the roadmap for the elimination of the SEC's US GAAP reconciliation is concerned, it appears that the convergence that these proposals would achieve is sufficient. Another concern is that sufficient work may not have been carried out on the two alternatives under consideration—immediate expensing and capitalisation of the actual borrowing costs incurred—to be sure that capitalisation is the better approach in the context of the other requirements in IFRS.

EFRAG has therefore decided to prepare a draft letter that questions the wisdom of making the change proposed. It will however also ask commentators whether they would prefer EFRAG to accept the change for roadmap purposes whilst at the same time urging the IASB to carry out a more comprehensive project to determine the optimal accounting treatment of borrowing costs. It is expected that EFRAG's draft comment letter will be issued on EFRAG's website (www.efrag.org) in a few days.

As already mentioned, the CFSS at its meeting on 13 June discussed a draft of the paper the CNC staff had prepared as part of **the PAAinE project on the Framework**. EFRAG considered the paper further at its meeting and made various suggestions as to how the paper might be improved. EFRAG also heard that the intention is to try to have the paper ready to be issued by early-September.

EFRAG has started to have educational sessions on **insurance** in preparation for the IASB Discussion Paper that is due to be issued by the end of the year and in order to take into account more fully the links between the insurance projects and some of the other projects it is working on. With this in mind, at its June meeting EFRAG discussed how the measurement of insurance liabilities (and related margins) should reflect risk and uncertainty. Further educational sessions will be held over the next few months.

EFRAG received a brief update on **the IFRIC's Service Concessions project** and the recent meeting of EFRAG's Service Concessions Working Party, at which IFRIC staff working on service concessions attended. It heard that Spain continued to have problems with what is being proposed, even though a number of changes were likely to be made to the draft Interpretations to address some of the concerns that EFRAG raised. IFRIC's project plan estimates that the final interpretations will be issued in Quarter 4 2006. EFRAG will continue to monitor the project closely.

Finally, EFRAG had an initial discussion of **the dates for its meetings in 2007**. A final set of dates will be posted on EFRAG's website (www.efrag.org) by the end of the month.

The next EFRAG meeting will be from **10 to 12 July 2006** in Brussels.

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