



## EFRAG TEG **UPDATE** JUNE 2007

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### Summary of the EFRAG TEG meetings in May and June 2007

On Wednesday 29 May to Friday 1 June 2007 EFRAG held its monthly meeting and discussed:

- Amendment to IFRS 2 *Vesting Conditions and Cancellations*
- Amendment of IAS 1 relating to Phase A of the Financial Statement Presentation project
- IASB's ED of proposed amendments to IAS 24 *Related Party Disclosures: State-controlled Entities and the Definition of a Related Party*
- IASB's ED of proposed amendments to IFRS 1 *Cost of an Investment in a Subsidiary*
- PAAinE project on Pensions
- PAAinE project on Equity/liability
- IAS 23 (Revised) *Borrowing Costs*
- IASB's *Insurance Contracts* Discussion Paper
- PAAinE project on Stewardship

On Monday 25 June EFRAG held an additional one-day meeting to discuss the IASB's *Insurance Contracts* Discussion Paper.

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#### Meeting on 29 May – 1 June

The IASB is expected to issue an **Amendment to IFRS 2 *Vesting Conditions and Cancellations*** in July. EFRAG had an initial discussion about the draft endorsement advice it might issue in April, and that discussion continued at its May/June meeting.

A general concern that some EFRAG members have about the Amendment is that it might make what is already a relatively rules-based standard that has an underlying rationale that is difficult to understand even more rules-based and difficult to understand. The best standards are principles-based standards that are written at a relatively high-level. However, subject to that EFRAG members were broadly content with what the Amendment is expected to say, except that they have some concerns about what it is likely to say about employee cancellations. In particular, the Amendment is expected to require all cancellations to be accounted for in the same way—by recognising immediately the amount of the expense that would otherwise have been recognised over the remainder of the vesting period (an accelerated vesting). EFRAG members agree that is the appropriate accounting treatment for employer cancellations, but some believe that employee cancellations are not accelerated vestings and should therefore not be treated as if they are. Those members recognise that in most cases it will not be possible to distinguish employee cancellations from employer cancellations, and that in those circumstances all cancellations should be treated in the same way—as accelerated vestings. The issue is whether there might be some cases where it will be possible to identify a genuine employee cancellation. The tentative view of most EFRAG members was that it was acceptable for the Amendment to treat all cancellations in the same way because it would be possible to differentiate between the different types of cancellation only rarely.

EFRAG members also considered a draft letter recommending endorsement. The draft discussed will be amended to reflect the detailed comments made at the meeting, and will be finalised and issued for comment when the Amendment has been issued.

EFRAG also considered a near-final draft of an **Amendment of IAS 1 relating to Phase A of the Financial Statement Presentation project**. The final Amendment is expected to be issued in July and is expected to require:

- Changes in net assets that have not arisen as a result of transactions with owners as owners (so-called non-owner changes in equity) to be shown in either one or two statements of comprehensive income, and no owner changes in equity can be included in that statement or those statements.
- The effects of recycling to be disclosed.
- The income tax relating to each component of other comprehensive income to be disclosed separately.
- A balance sheet showing the position at the beginning of the corresponding period to be presented if there has been a prior year adjustment.
- Dividends to be disclosed either on the face of the statement of changes in equity or in the notes, but not in the statement(s) of comprehensive income.

The names of the primary financial statements will also be changed, although entities will not be required to use the new names in their published financial reports.

EFRAG had its first discussion of the draft Amendment at its meeting in April and had tentatively concluded that the only significant concern, from an endorsement point of view, was the requirement to disclose the income tax relating to each component of other comprehensive income separately. This concern arose because it was thought that the numbers would be arbitrary and therefore of little value to users. At its May/June meeting EFRAG discussed this issue again. Members generally thought the key issue for the purpose of the endorsement advice was whether the information could be misleading or disproportionately costly to provide; and EFRAG members' tentative view was that it would be neither.

EFRAG members also considered a draft letter recommending endorsement of the Amendment. Although various amendments were suggested to the letter, EFRAG was broadly supportive of its content. The draft will be finalised and issued for comment when the Amendment has been issued by the IASB.

In recent months EFRAG has been discussing various aspects of the **IASB project on Business Combinations** in order to develop its thoughts on the draft endorsement advice it might give when the revisions to IFRS 3 *Business Combinations* and IAS 27 *Consolidated and Separate Financial Statements* are issued in the summer or early autumn. At its May/June meeting, EFRAG members discussed two issues: accounting for non-controlling Interests (NCI) and accounting for step acquisitions.

EFRAG members have previously discussed the possibility of the IASB requiring entities to measure any NCI at their fair value at the time the reporting entity acquired a controlling interest. A number of EFRAG members are not comfortable with that accounting treatment, for a variety of reasons. However, the IASB has decided that, rather than require all entities to fair value NCI, entities will instead be allowed a choice: they can either fair value NCI or they can account for NCI in broadly same the way they do at present. The issue for EFRAG in developing its draft endorsement advice is whether the concerns they have about fair valuing NCI are addressed by allowing a choice. For example, if the concerns were that fair valuing NCI did not meet the cost-benefit test, allowing an option ought to address that concern because, if the cost-benefit test was not met, entities could simply apply the other option. However, if the concern was that fair valuing NCI was an inappropriate accounting treatment, allowing a choice would not help. It was also noted that introducing an option might itself raise issues. In the ensuing discussion it became clear that some members do have some concerns about whether fair valuing NCI is an appropriate accounting treatment.

EFRAG members then discussed the IASB's latest thinking on step acquisitions and disposals, which is that the portion of the interest that is held both immediately before and immediately after control is acquired or disposed of should be remeasured at fair value, with gains or losses being recognised in the income statement. Generally EFRAG members agreed that the interest should be remeasured, but were less comfortable about the gains and losses being recognised in the income statement.

Some EFRAG members were also concerned about the IASB's decision not to re-expose, and the implications of this for EFRAG's endorsement advice were considered.

EFRAG's discussions of this subject will continue.

At its May/June meeting, EFRAG also considered its comment letter on the **IASB's ED of proposed amendments to IAS 24 Related Party Disclosures: State-controlled Entities and the Definition of a Related Party**. EFRAG had issued its draft comment letter in April, and the purpose of the session was to consider the comments received in response to that draft and to finalise the letter. Having considered the responses, EFRAG decided to retain the suggestion made in its draft letter that the exemption proposed in the ED should be extended to all entities and not just to state-controlled and state-influenced entities. Various minor amendments to the draft letter were agreed, and it is expected that EFRAG's final letter will be issued around the end of June. At that time, it will be available from EFRAG's website ([www.efrag.org](http://www.efrag.org)).

EFRAG also discussed its comment letter on the **IASB's ED of proposed amendments to IFRS 1 Cost of an Investment in a Subsidiary**. The ED proposes granting relief from two requirements of IAS 27 to entities applying IFRS for the first time. One of the reliefs the ED proposed was that parent entities preparing individual financial statements could deem the cost of an investment in a subsidiary to be the transition date net asset value of the subsidiary or the transition date fair value. In its draft letter, EFRAG had agreed that relief was needed, but had suggested that the standard should also permit entities to use the previous GAAP equity accounting number as the deemed cost. The responses EFRAG received agreed that relief was needed and also agreed with EFRAG's view that the relief being proposed was insufficient, but they suggested a range of other possible deemed cost approaches. EFRAG had considered the responses at its April meeting and had asked staff to analyse the various suggestions made.

EFRAG considered that analysis at its May/June meeting and decided that the message in EFRAG's draft letter should remain unchanged, except that it should suggest amending one of the reliefs proposed in the ED (the transition date net asset as deemed cost approach) to take into account goodwill and should suggest that the final standard should permit entities to treat as the deemed cost of their investment in their subsidiaries the transition date net carrying amount of the subsidiary (including related goodwill) included in the consolidated IFRS financial statements after adjusting for consolidation and equity accounting adjustment and for the effects of the business combination in which the entity acquired the subsidiary.

Various other minor amendments to the draft letter were also agreed. The final comment letter has now been issued and is available from EFRAG's website ([www.efrag.org](http://www.efrag.org)).

EFRAG also received an update on developments in the **PAAinE project on Pensions**. The project is taking a fresh look at all the fundamentals that underlie our existing approach to pension accounting in order to develop some European thinking on how pension accounting should develop in the future. Thus, the project is reconsidering, for example:

- The recognition and measurement of pension-related assets and liabilities,
- How changes in those assets and liabilities should be dealt with in the performance statement(s), and
- Whether the existence of retirement benefit funds and similar arrangements make any difference to the accounting and whether, for example, such funds should be consolidated.

It was noted that some discussion summaries highlighting the main tentative views reached to date are available from the PAAinE Pensions project page of EFRAG's website ([www.efrag.org](http://www.efrag.org)). Work on this project will continue, and it is hoped that a final paper will be issued later in the year.

EFRAG also discussed the **PAAinE project on Equity/liability**. This project is looking again at the fundamental principles that should distinguish equity from liabilities. Currently, the tentative view is that instruments should be classified as equity if, and to the extent that, they are loss absorbing; instruments that are not equity will be classified as liabilities. A paper explaining those tentative conclusions was presented at the recent joint IASB/FASB meeting, and has also been discussed with the IASB's Financial Instruments Working Group. As a result of the discussions at those meetings, the project leaders have decided to re-examine and develop further some of the notions that underpin the tentative conclusions. At the May/June meeting, EFRAG provided comments and other input on some of those notions.

In April EFRAG issued for comment its draft endorsement advice letter on **IAS 23 (Revised) Borrowing Costs**. That draft recommended that IAS 23 Revised should be endorsed, although two EFRAG members dissented from that decision. At its May/June meeting, it considered the comments received on the draft letter in order to finalise the advice.

All but two of the responses received supported the view in EFRAG's draft letter that the revised standard should be endorsed, although some of those supporting endorsement had also raised concerns about the standard. All but one of the concerns mentioned in the letters raised issues that EFRAG had considered in developing its draft advice. EFRAG members therefore considered whether they had given appropriate weight to those concerns and also whether they had drawn the right conclusions from them. The additional concern related to the IASB's decision in this project to remove an option in order to ensure all entities would converge onto US GAAP. It was noted that in other projects the IASB has introduced options that would enable entities to avoid converging with US GAAP. Some members thought this had implications for EFRAG's assessment of the costs and benefits of the revision to IAS 23.

After discussion, EFRAG agreed that its final letter should, like the draft letter, recommend endorsement, although four members dissented from that decision. Some changes to the letter were also agreed. EFRAG's final advice letter, recommending endorsement, has now been issued and is available from EFRAG's website ([www.efrag.org](http://www.efrag.org)).

EFRAG members also received a presentation from Peter Clark of the IASB staff on the **IASB's Insurance Contracts Discussion Paper**. The objective of the session was to provide an introduction to the paper, and thereby help EFRAG members to develop a better understanding of the paper's proposals in advance of the special meeting on Insurance on 25 June. Members of EFRAG's Insurance Accounts Working Group also participated in the session.

In April EFRAG agreed to join with various other standard-setters in working on a short-term **PAAinE project on Stewardship**. In the Framework Discussion Paper the IASB and FASB issued last year, they argued that the objective of financial statements is to provide information that is useful to users in making resource allocation decisions ('the resource allocation decision usefulness objective'). If this objective is met, the Boards argued, the financial statements would also provide information useful in assessing management's stewardship ('the stewardship objective'); so stewardship does not need to be a separate objective. Many of those responding to the discussion paper disagreed with this proposal. In their view, the stewardship objective is not encompassed within the resource allocation decision usefulness objective; it is a broader objective and needs to be recognised as a separate objective of financial statements. Bearing all this in mind, the aim of the PAAinE project is to help the Boards by:

- analysing the comments they received on stewardship to determine whether respondents are talking about broadly the same notion, or have very different ideas about what the stewardship objective involves;
- (if respondents are talking about broadly the same notion) developing from the comments a description of the stewardship objective;
- comparing that description with the resource allocation decision usefulness objective to determine whether the former is encompassed within the latter; and
- (if it is not) considering the implications of recognising a separate stewardship objective.

At its meeting in May and June, EFRAG members discussed and provided their input on a draft of the proposed paper. The general feeling was that the paper was nearing completion and, subject to some final amendments, was ready to be issued. The paper has since been issued, jointly by EFRAG and various European standard-setters. A copy of the paper is available from EFRAG's website ([www.efrag.org](http://www.efrag.org)).

**EFRAG TEG meeting on 25 June**

On 25 June, EFRAG held a special one-day meeting to discuss the **IASB's Insurance Contracts Discussion Paper**. The objective of the meeting was to start developing views for inclusion in EFRAG's draft comment letter on the paper. The discussion focused on liability recognition and measurement; in particular on the rationale for and appropriateness of the proposals on risk margins, service margins, non-entity specific measures, and the treatment of policyholder behaviour. EFRAG members discussed the proposals both as they applied to insurance liabilities and also as they might apply to other types of liabilities. No final decisions were taken and EFRAG's discussion will continue at its July meeting.

EFRAG will hold its next meeting in Brussels on **Wednesday 11 to Friday 13 July 2007**. On 11 July, EFRAG will be meeting with the national standard-setters of Europe in the Consultative Forum of Standard-setters (CFSS).

EFRAG has recently issued, jointly with various European standard-setters, a PAAinE paper entitled *Stewardship/Accountability as an Objective of Financial Reporting: A comment on the IASB/FASB Conceptual Framework Project*. The paper can be downloaded from EFRAG's website ([www.efrag.org](http://www.efrag.org)).

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