



EFRAG TEG **UPDATE** SEPTEMBER 2007

Summary of the EFRAG CFSS and TEG meetings in September 2007

On Wednesday 5 September 2007 EFRAG TEG (EFRAG) met with the national standard-setters of Europe in EFRAG's Consultative Forum of Standard-Setters (CFSS) to discuss:

- IFRIC D21 *Real Estate Sales*
- The IASB's US Convergence project
- The PAAinE Discussion Paper *Revenue Recognition—A European Contribution*

On Thursday 6 and Friday 7 September 2007 EFRAG held its monthly meeting and discussed:

- IFRIC D21 *Real Estate Sales*
- The IASB's *Insurance Contracts* Discussion Paper
- The IASB's US Convergence project
- IFRIC D22 *Hedges of a Net Investment in a Foreign Operation*
- IFRIC 13 *Customer Loyalty Programmes*
- The IASB's Annual Improvements Project
- The so-called 'IFRS Branding' issue
- The IASB's work on the Reporting Entity
- The PAAinE project on Pensions

EFRAG CFSS meeting on 5 September 2007

In July the IFRIC issued a draft interpretation, **IFRIC D21 *Real Estate Sales***. In existing IFRS there are two revenue standards and transactions fall within IAS 11 *Construction Contracts* if they involve a construction contract, a term which IAS 11 defines; otherwise, they are within IAS 18 *Revenue*. D21 clarifies how that definition of a construction contract should be applied to real estate transactions; for example, to a contract to buy an apartment in an apartment block that is entered into before construction of the apartment has been completed.

EFRAG had an initial discussion of the draft at its meeting in July, and had identified a number of issues. At the September CFSS meeting, participants were asked for their views on the draft. They were particularly asked for their views on how D21's draft consensus might work for analogous transactions.

- D21 proposes that IAS 11 should be applied when a contract involves providing construction services to the buyer's specification. Participants expressed differing views as to whether this was two criteria (construction *services* and buyer's specifications) or just one criterion (buyer's specifications) and, if it was two, whether the 'construction *services*' criterion was appropriate.
- D21 also proposes some features that might indicate that a particular contract either is or is not a contract that involves providing construction services to the buyer's specification. One set of features focuses on the extent of the buyer's ability to determine the major structural elements of the real estate involved; and the second set focuses on the extent to which there is delivery of the work being carried out under the contract. Participants expressed concern about the second set of features because they did not believe that IAS 11 currently requires continual delivery.

EFRAG took these comments into account in its own discussion of D21 later in the week.

Every six months a delegation—comprising the Chairs of EFRAG and of the standard-setters of France, Germany and the UK and others—meet with representatives of the IASB to discuss **the IASB's US Convergence project**. Prior to that meeting, EFRAG consults with participants at the CFSS meeting as to the issues to be discussed at the meeting and the messages to be conveyed. The next six monthly meeting is in October, so participants discussed possible agenda items for the meeting.

Participants also heard that the fourth paper prepared under the Pro-active Accounting Activities in Europe (PAAinE) initiative was issued in July. Although many people think initially that they know what revenue—the top line of the income statement—is and when it arises, closer analysis reveals inconsistencies, both in practice and in the existing literature. The IASB and FASB have a project that is looking to develop clear revenue principles that can be applied consistently to all types of business activity. Recognising the importance of Europe participating fully in this global debate, the **PAAinE Discussion Paper Revenue Recognition—A European Contribution** has been issued to encourage early debate within Europe. The paper was prepared by the German standard-setter and EFRAG. At the meeting, participants discussed ways of bringing the paper to the attention of as many people as possible. They also discussed other steps that could be taken to encourage debate within Europe.

The paper can be downloaded from EFRAG's website (www.efrag.org). Comments are invited by 10 December 2007.

EFRAG TEG meeting on 6 and 7 September 2007

EFRAG started its September meeting by continuing its consideration of **IFRIC D21 Real Estate Sales**. It also considered an initial draft of an EFRAG comment letter, prepared by staff on the basis of EFRAG's discussion of D21 in July, and the comments made by the national standard-setters at the CFSS meeting (see summary of that discussion on the previous page).

Differing views were expressed about key aspects of the draft interpretation, largely due to what was perceived to be a lack of clarity in the draft interpretation as to the thinking that underlies the reference to "construction services" and how the references to "buyer's specifications" and "continual delivery" can be reconciled to existing IAS 11. Some EFRAG members were also concerned about the implications were D21's consensus to be applied by analogy to transactions other than real estate sales. Some concerns were also expressed about the proposed changes to the implementation guidance in IAS 18. Various changes to the draft letter were agreed to reflect those concerns.

EFRAG has now issued its draft comment letter. It is available from EFRAG's website (www.efrag.org) and comments on the letter are invited by 18 October 2007.

At its September meeting, EFRAG also discussed **the IASB's Insurance Contracts Discussion Paper**. EFRAG members noted that the discussion paper raised a number of issues that are currently being addressed in major projects being carried out by the IASB and FASB. If those issues had been thoroughly discussed in the Insurance paper it would have been possible for EFRAG to comment on them but, in the absence of such a discussion, it proved difficult for EFRAG to reach firm conclusions on the proposals for the measurement of insurance liabilities; particularly on the proposals to ignore entity specific cash flows and to include margins that are estimates of the amount of compensation a market participant would demand to provide the same services. EFRAG members also raised concerns about the paper's focus on market exit value; its proposals on policyholder behaviour, unbundling, and own-credit risk; and about the continued risk under the proposals of accounting mismatches.

It is expected that EFRAG's draft comment letter will be available from EFRAG's website (www.efrag.org) from early October.

As mentioned earlier, every six months a European delegation meets with representatives of the IASB to discuss **the IASB's US Convergence project**. EFRAG members reflected on the comments made at the CFSS meeting as to possible agenda items for the meeting, and made a number of suggestions of their own. The meeting with IASB representatives will be in public and will take place on 15 October at the IASB's offices.

EFRAG also discussed **IFRIC D22 Hedges of a Net Investment in a Foreign Operation**. D22 clarifies that the foreign exchange differences that arise between the functional currency of the foreign operation and the presentation currency of the parent entity do not represent a hedgeable risk. The hedgeable risk is the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any parent entity (ie the immediate, intermediate or ultimate parent entity of that foreign operation). D22 also clarifies that hedge accounting is available regardless of which entity or entities within the group hold the hedging instrument.

EFRAG members agreed with the draft consensus, although they identified some areas in the draft interpretation that might benefit from further clarification.

EFRAG has now issued its draft comment letter. It is available from EFRAG's website (www.efrag.org) and comments on the letter are invited by 19 October 2007.

IFRIC 13 Customer Loyalty Programmes was issued in June. Some entities grant 'points', air miles or other award credits to their customers as part of a sales transaction with those customers, and IFRIC 13 explains how existing standards should be applied to such transactions. It requires:

- the transactions to be treated as comprising two elements—the basic sale transaction and the sale of rights in respect of a future transaction;
- the fair value of the total consideration received to be allocated between the two elements by reference to their fair value; and
- recognition in the income statement of the consideration allocated to the grant of award credits to be deferred until, usually, the award credits are redeemed.

EFRAG discussed at its July meeting the draft endorsement advice it should give on IFRIC 13 and a majority of members agreed that EFRAG should recommend endorsement. In September EFRAG members considered a draft endorsement advice letter that had been revised to reflect comments made during July's discussion and agreed that, subject to various minor amendments, the letter should be issued for comment.

EFRAG's draft endorsement advice on IFRIC 13 is now available from EFRAG's website (www.efrag.org). Comments on the letter are invited by 7 October 2007.

Changes to IFRS, however small, are time-consuming and burdensome for all those with an interest in the standard-setting process. With the intention of easing the burden for all concerned, the IASB has developed a process for dealing with non-urgent, minor amendments to IFRS (termed the 'annual improvements process'). This process involves the IASB discussing proposals for non-urgent, minor amendments to standards throughout the year and then, once a year, issuing a combined ED (and eventually a combined IFRS implementing the changes). The first ED in **the IASB's Annual Improvements Project** is expected to be issued in early October. EFRAG members discussed some of the expected proposals at its July meeting, and it discussed some more expected proposals in September.

EFRAG also discussed **the so-called 'IFRS Branding' issue** at its September meeting, which the IASB is intending to address as part of the Annual Improvements project. The IASB has noted that entities that are complying in full with IFRS are often not stating that fact in their financial statements. The IASB is also apparently concerned that, in some jurisdictions, entities may give the impression, by their references to IFRS, that their financial statements are very similar to IFRS-compliant financial statements when in fact they are very different. Therefore, the IASB has tentatively decided to propose that entities should be required to explain precisely the extent to which they have complied full IFRS and to describe how the financial statements would have differed had full IFRS been adopted.

EFRAG discussed the IASB's concerns and the solution it intends to propose. EFRAG members generally agreed that an entity should disclose its accounting policies in sufficient detail for users to understand whether, amongst other things, the entity has complied with IFRS in full. They also thought that, if users are assuming from references to financial statements being prepared in accordance with, say, "IFRS as adopted in XXX" that the financial statements will be very similar to IFRS-compliant financial statements, this is an educational issue rather than a standard-setting issue. Finally, EFRAG members generally thought there was something inappropriate about the IASB saying in effect that entities should comply with IFRS but, if they do not, they should provide a particular disclosure.

EFRAG will continue to monitor the IASB's work on this issue.

Currently the IASB and FASB have separate conceptual frameworks that are similar but different. A couple of years ago they started to develop a converged and improved framework. This work has been broken down into phases, with each phase representing a separate section of the framework. A discussion paper on Phase A—which dealt with the objectives of financial reporting and the qualitative characteristics of financial information—was issued in 2006 and the next output will be a discussion on Phase D, which deals with the notion of a reporting entity. At its September meeting EFRAG discussed **the IASB's work on the Reporting Entity**. In particular, EFRAG considered the following aspects of the forthcoming discussion paper.

- The Boards' tentative decisions not to define 'an entity'—except to say that it will be some sort of area of economic interest to users of general purpose external financial reports (GPEFR)—and to define 'a reporting entity' as an entity that either is required to, or chooses to, prepare GPEFR. EFRAG members generally thought the framework probably needed clearer principles on both these issues.
- How the composition of a group entity should be determined for financial reporting purposes. The Boards have tentatively decided that a controlling entity approach should be adopted. This is broadly the approach used now. EFRAG members generally agreed with this, although they were concerned about how this could be reconciled with the current use of a risk and rewards approach to deal with special-purpose entities (SPEs).
- The Boards' tentative decision that, for control to exist, there must be power (ie an existing ability to direct the financing and operating policies of another entity) and the ability to use that power for one's own benefit. EFRAG members noted that this too was similar to the existing approach.
- The status of parent-only financial statements when that parent also prepares consolidated financial statements. Are both sets of financial statements GPEFR or are only the consolidated financial statements GPEFR? It was noted that most FASB members think that generally only the consolidated financial statements are GPEFR—a view that is consistent with existing practice in the US—and that the IASB was split on the subject. EFRAG members noted that existing practice in Europe is varied; in some jurisdictions, both consolidated and parent-only financial statements are required to be provided, while in some other jurisdictions consolidated financial statements together with some extracts from the parent-only financial statements are required. EFRAG members generally thought that both sets of financial statements are GPEFR.

EFRAG will continue to monitor this project.

EFRAG also discussed aspects of the **PAInE project on Pensions**. This project, which is being led by the UK standard-setter, is looking at all aspects of accounting for pensions and other post-employment benefit plans. This is being done because there is a widely-held view that the accounting standards around the world on accounting for post-employment benefit plans need to be rethought, and Europe has some views on how that should be done. The paper is expected to be issued by the end of the year, and EFRAG will be working its way through the paper over the next couple of months.

EFRAG's next meeting will be on **Wednesday 10 and Thursday 11 October 2007** in Brussels.

EFRAG has issued, jointly with various European standard-setters, a PAInE discussion paper entitled *Revenue Recognition: A European Contribution*. Comments on the paper are invited by 10 December 2007. The paper 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