



## Summary of the EFRAG TEG meeting in July 2006

On Tuesday 11 and Wednesday 12 July the Technical Expert Group of EFRAG (EFRAG) held its monthly meeting and discussed the following topics:

- The joint IASB/FASB project on Liabilities
- The IASB ED of Proposed Amendments to IAS 1 *Presentation of Financial Statements: A Revised Presentation*.
- The IASB ED of Proposed Amendments to IAS 32 and IAS 1 *Puttable Instruments and Obligations Arising on Liquidation*
- The IASB project on the cost of a subsidiary in the individual financial statements of a parent on first time application of IFRS
- The IASB Discussion Paper on the Conceptual Framework
- The IFRIC project on Interim Financial Reporting and Impairment
- The FASB Invitation to Comment on Bifurcation of Insurance Contracts
- The PAAinE projects on the Conceptual Framework, Equity/Liability, and Performance Reporting

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EFRAG received an update on the decisions taken recently in **the joint IASB/FASB project on Liabilities** and discussed an IASB staff paper that explored aspects of the IASB's proposal that the liability recognition criteria in IAS 37 should be amended to exclude the probability criterion. EFRAG first discussed the reasoning the IASB staff paper suggested might be used to support the omission of the probability criterion.

- In the ED, the IASB had argued that the probability criterion was not necessary because there would always be an outflow of resources embodying economic benefits to settle the obligation. EFRAG had said in its comment letter that this reasoning was flawed. The paper sought to expand on and refine the ED's reasoning, but EFRAG members still found it unconvincing. EFRAG also noted that during the IASB's debate it had been asserted that IAS 37's probability criterion is currently being widely misapplied. EFRAG members expressed grave concerns about that assertion.
- EFRAG noted that an alternative reasoning involved accepting that, if the probability criterion is to be omitted, the Framework needed to be amended. This is the view that EFRAG expressed in its comment letter.

EFRAG then discussed the technical merits of recognising all liabilities at an amount based on expected value regardless of how likely the liability is to result in an outflow of resources. A number of concerns were raised about that approach, including:

- how easy it would be to determine the probability numbers needed to estimate a reliable expected value number; and
- the likelihood that the approach would result in a significantly increased number of liabilities needing to be recognised. It was noted that the staff paper argued that that would not be the case, but EFRAG members were unconvinced by the arguments used.

EFRAG will continue to follow the debate closely.

Earlier in the year, EFRAG issued a draft comment letter on the **IASB ED of Proposed Amendments to IAS 1 Presentation of Financial Statements: A Revised Presentation**. At its July meeting EFRAG considered the comments it received on that letter.

EFRAG discussed the ED's proposal that entities should be allowed to choose whether to present one performance statement or two. It was noted that it was rather simplistic to view this proposal as involving simply the addition of an option; because the proposal also involves:

- downgrading the status of the income statement, and
- recharacterising existing practice (ie the continued presentation of an income statement and (what is currently known as) the statement of recognised income and expenses) as involving the splitting of the statement of comprehensive income. (which under the proposals would henceforth be known as the statement of recognised income and expenses).

EFRAG considers these to be fundamental changes. In its view, such changes should not be made without having a comprehensive debate, and that debate is not due to take place until the next stage of the project.

Another of the proposals in the ED is that the names of the primary financial statements should be changed, although entities would not be required to use those new names in their financial statements. In its draft letter, EFRAG stated that—although it saw no benefit in the name changes, was concerned about the potential confusion the changes would cause and would prefer no decision to be taken on the changes until the next stage of the project had been completed—it was prepared to accept the changes as long as entities were not compelled to use the new names. However, EFRAG was persuaded by arguments in the letters received that it should change its position and argue that the changes should not be made at this stage.

EFRAG also discussed the presentation of the effect of changes in accounting policies. In its draft letter EFRAG had noted that the ED was not clear as to in which primary financial statement the effects of changes in accounting policies should be shown. It had also asked constituents whether they believed such effects should be presented amongst income and expenses. After discussing the responses received, EFRAG decided to ask for a clarification of the presentation required.

It was agreed that no other significant changes should be made to the draft letter.

EFRAG's final comment letter will be issued in the next few days and will be available from EFRAG's website ([www.efrag.org](http://www.efrag.org)).

EFRAG also discussed progress on the **IFRIC project on Interim Financial Reporting and Impairment**. Earlier in the year, IFRIC had issued a draft Interpretation (D18) that sought to address an apparent conflict between the requirements of IAS 34 on interim financial reporting and the impairment requirements of IASs 36 and 39. In its letter of comment on D18, EFRAG:

- argued that an IFRIC Interpretation could not resolve a conflict between two standards; only an amendment to one or other (or both) standards could do that. However, EFRAG also accepted that the issue being addressed was causing problems and needed to be clarified, and in view of that it said it was prepared to support the use of an Interpretation in the short-term;
- supported the solution to the issue as described in the consensus paragraph; and
- pointed out that the transitional arrangements as drafted were inconsistent with IAS 36.

EFRAG heard that IFRIC had completed work on the Interpretation, which would be issued later in July as IFRIC 10. It was informed that the consensus paragraph remained as set out in D18, that its concerns about the transitional arrangements had been addressed, and that there had been no other significant changes made to the text as set out in D18. In the light of this, EFRAG was asked to discuss the endorsement advice it would give on IFRIC 10.

After discussion, EFRAG agreed that, subject to reviewing IFRIC 10, its draft advice would be to recommend endorsement.

EFRAG also considered whether the IASB's and IFRIC's decision to use an IFRIC Interpretation to address a conflict between standards might have implications for endorsement or for EFRAG's endorsement advice, and tentatively concluded that it did not.

EFRAG will finalise its draft endorsement advice when IFRIC 10 has been issued.

EFRAG discussed the recently issued **IASB ED of Proposed Amendments to IAS 32 and IAS 1 Puttable Instruments and Obligations Arising on Liquidation** in order to prepare a draft comment letter on the ED. EFRAG had discussed the proposals in draft form on two previous occasions, as had its Financial Instruments Working Group. Based on those discussions, the EFRAG staff had prepared a draft comment letter for EFRAG to consider. The letter was critical of the proposals, arguing that a case had not been made for change and the changes being proposed were in any case flawed and rules-based. EFRAG agreed with the overall message of the draft, but asked for various detailed changes to be made. For example, the draft will be revised to argue that, if the IASB decides to proceed despite the concerns expressed by EFRAG, it should widen the amendment so that it addresses certain other anomalies that are causing a particular problem in Europe.

A revised draft comment letter will be issued on EFRAG's website ([www.efrag.org](http://www.efrag.org)) in the next few days for comment.

EFRAG also considered the first parts of **the IASB Discussion Paper on the Conceptual Framework**. (The remainder of the Discussion Paper will be discussed at the next EFRAG meeting.) The Discussion Paper is the first consultative paper issued as a result of the work the IASB and FASB are carrying out jointly to revise and converge their frameworks. The Introduction explains why frameworks are useful, Chapter 1 discusses the objectives of financial reports and Chapter 2 discusses the qualitative characteristics financial information should have. Although the changes that the IASB is proposing in the Discussion Paper to make to the equivalent material in its existing framework are in most cases not significant in substance, EFRAG considers the publication of the Discussion Paper to be very important because it represents the first real opportunity that Europe has had to discuss the concepts that underpin the financial reporting system that has been adopted in Europe.

The objective of EFRAG's discussion was to gather views for EFRAG's comment letter on the Discussion Paper. This process will continue at the next meeting, and it is currently expected that a draft comment letter on the whole paper will be issued on EFRAG's website by mid-September.

EFRAG discussed **the FASB Invitation to Comment on Bifurcation of Insurance Contracts**. Although the IASB is working on Phase 2 of its Insurance project, that work is not being carried out jointly with FASB. The intention is that FASB will issue the IASB Discussion Paper as an Invitation to Comment, and will then work with the IASB to develop proposals for a joint insurance standard. In the mean time, FASB has a short-term project that is looking at various ways of improving the existing US requirements on insurance accounting, and the Invitation to Comment on Bifurcation of Insurance Contracts has been issued as part of that work.

One of the issues that the IASB has been discussing in Phase 2 of its Insurance project is whether insurance contracts should be bifurcated—or unbundled—into components. IFRS 4, for example, already permits (and in some circumstances requires) some insurance contracts to be unbundled into their insurance and deposit components. Although the IASB has tentatively decided in Phase 2 of its project not to require unbundling, FASB, through its Invitation to Comment, is continuing to explore the possibility, albeit only within the context of US GAAP. EFRAG discussed the implications that this Invitation to Comment might have for the IASB's project. The possibility of writing to either FASB or the IASB about the Invitation to Comment was discussed and EFRAG staff was asked to prepare a draft letter to the IASB for consideration at a future EFRAG meeting.

In March 2006 the IASB added to its work programme a project on **the cost of a subsidiary in the individual financial statements of a parent on first time application of IFRS**. An ED is expected to be issued in the autumn. At its July meeting EFRAG had an initial discussion of the two issues being addressed in the project.

- IFRS 1 requires first time adopters of IFRS to show their investments in subsidiaries in their individual financial statements in accordance with IAS 27—in other words at cost or fair value. However, some entities will not have been measuring the investment at cost prior to the transition to IFRS and may therefore find it difficult to determine the cost. The

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first issue being discussed is whether (and if so how) to provide some sort of exemption for such entities.

- IFRS 1 and IAS 27 together require parent entities to determine, at the date of transition to IFRS, the amount of pre-acquisition reserves that their subsidiaries have. However, some entities may not have this information. The second issue is whether (and if so how) such entities should be given some sort of relief.

EFRAG discussed the alternative exemptions that the IASB is considering. It also discussed the IASB's tentative decision not to make those exemptions available to listed parent entities.

EFRAG will continue to monitor this project.

In June 2006 EFRAG and the European 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 July EFRAG discussed progress on three of those projects.

- **The PAAinE project on the Conceptual Framework** is being led by staff of the French standard-setter (the CNC), who are preparing a Discussion Paper addressing:
  - The objective(s) of the conceptual framework, and the implications this has for the framework itself
  - The scope of the Framework—in other words, to which financial reports prepared by which types of entity should the Framework apply?
  - Whether the users that frameworks focus on really have similar information needs and whether those needs can be satisfied by a single set of financial statements.
  - The extent to which financial theory, including notions of capital maintenance, should be reflected in the framework.

EFRAG discussed the latest draft of the paper and made suggestions as to how it might be developed.

- **The PAAinE project on Equity/Liability** is being led by staff of the German standard-setter (the GASB). EFRAG received a presentation setting out some of the preliminary views being reached in the project and made suggestions as to how those views might be developed.
- **The PAAinE project on Performance Reporting** is being led jointly by staff of the Spanish standard-setter (ICAC) and EFRAG staff. The first stage of the project is to develop and issue a paper that explains briefly why some believe there may be a need for major changes in the way that entities present information about their financial performance and why some others believe such changes are not necessary. EFRAG discussed a draft of the proposed paper and made suggestions as to how it might be developed.

The next EFRAG meeting will be from **30 August to 1 September 2006** and will be held in Brussels.

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