



EFRAG - TEG **UPDATE** SEPTEMBER 2006

Summary of the EFRAG TEG meeting in September 2006

On Wednesday 31 August through to Friday 1 September 2006 the Technical Expert Group of EFRAG (EFRAG) held its monthly meeting and discussed the following topics:

- The IASB project on SMEs
 - The joint EFRAG/GASB project on Revenue Recognition
 - The IFRIC project on Customer Loyalty Programmes
 - The EFRAG User Panel
 - IFRIC 10 *Interim Financial Reporting and Impairment*
 - IFRIC D19 *IAS 19—The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements*
 - The IASB Discussion Paper on the Conceptual Framework
 - The European Commission's Roundtable meetings
 - The PAAinE projects on the Conceptual Framework and Performance Reporting
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EFRAG has been following **the IASB project on Small and Medium-sized Entities (SMEs)** closely. As it now seems that the IASB will be issuing a 200-plus page exposure draft (ED) of an IFRS for SMEs around the end of the year, EFRAG has started to discuss the proposals as set out in the publicly-available draft ED, which though not approved by the IASB is the best indication there is at present of what the ED is likely to contain.

At its September meeting, EFRAG discussed some overarching issues (ie scope, concepts and pervasive principles, and the hierarchy) and organisational issues (ie the use of cross references to full IFRS, and how the IFRS is to be kept up-to-date). No decisions were taken as to the approach to be adopted in EFRAG's draft comment letter on these issues, although EFRAG members:

- raised some detailed concerns on the scope paragraphs in the current draft;
- raised some concerns about the draft's approach to concepts and pervasive principles. Some members, for example, questioned the value of the recognition and measurement principles when the individual sections of the draft contain transaction-specific recognition and measurement requirements. The main value of the principles seems therefore to be through their role in the IFRS' version of IAS 8's hierarchy, although some members questioned whether they were comprehensive and detailed enough to fulfil that role;
- discussed whether the hierarchy in the IFRS for SMEs should refer to full IFRS and generally whether the IFRS for SMEs should contain cross-references to full IFRS; and
- broadly supported the draft's suggestion that the IFRS for SMEs should be maintained largely by issuing proposed amendments every other year.

EFRAG also discussed the proposals on financial instruments in the current draft. Again EFRAG took no decisions on the approach it would follow in its draft letter, but members:

- broadly supported the main simplifications set out in this section of the current draft, including the ones relating to hedge accounting;
- thought parts of the material were difficult to follow. For example, there were differing views as to what the draft required in respect of derivatives, particularly embedded derivatives;
- raised some issues concerning the scope paragraphs, particularly in respect of insurance obligations and leasing; and

- questioned whether the section on the derecognition of financial assets and financial liabilities was complete without some material on transfers in which the transferor retains a continuing involvement in the asset.

Finally, EFRAG discussed the current draft's proposals on consolidated financial statements, business combinations and goodwill. Again, although no final decisions were taken, EFRAG members were broadly supportive of the main proposals involved except that some believed that the IFRS for SMEs should permit or require SMEs to apply an amortisation approach rather than an impairment approach to goodwill.

EFRAG will discuss other parts of the latest proposals at subsequent meetings.

EFRAG and the German standard-setter are carrying out a **joint EFRAG/GASB project on Revenue Recognition**. The project's objectives are to enhance the awareness within Europe of the issues being addressed by the IASB and FASB in their joint revenue recognition project and to develop some European ideas on the subject. The intention is that EFRAG and GASB will develop their own discussion paper, setting out a European perspective of the issues.

At its September meeting EFRAG considered the latest draft of the paper. EFRAG provided the staff working on the paper with advice and suggestions on how it should be developed.

Work on the paper will continue, and a revised draft will be used as the basis for an Advisory Forum that the EFRAG Supervisory Board is organising for October. Details of that Advisory Forum are available from EFRAG's website (www.efrag.org).

At its September meeting, EFRAG also discussed **the IFRIC project on Customer Loyalty Programmes**. Such programmes are used in a range of businesses and include air mile schemes and supermarket loyalty points schemes to name but a few. EFRAG considered a summary of the expected content of a draft Interpretation that IFRIC was developing. (Since the meeting, IFRIC has issued the draft as IFRIC D20 *Customer Loyalty Programmes*).

Currently there are a number of different practices that are being adopted to account for customer loyalty programmes. For example:

- some companies treat the initial transaction—for example, the sale of an airline ticket with an award of air miles attached—as a multiple element arrangement, and allocate the revenue on that original transaction between the sale of the ticket and the sale of the air miles. The revenue allocated to the sale of the air miles is then treated as a payment in advance. (This is known as the 'deferral method'.) Other companies view the award of air miles as similar to incurring an expense so a liability and an expense equal to the expected cost of meeting the obligations arising out of the award is recognised. (This is referred to as the 'cost method');
- different approaches are adopted to measurement. For example, under the deferral method some measure the amount of the payment in advance (ie the deferred revenue) at an amount that includes an allocation of profit, and some measure it by reference to cost. Furthermore, when measuring cost, some adopt a marginal cost basis with no or limited allocation of non-marginal costs and others include an allocation of non-marginal costs;
- some companies account for the awards they sell to other companies in one way (for example, using the deferral method) and the awards they grant their own customers in a different way (for example, the cost method).

IFRIC is proposing that the deferral method should be used and that the revenue deferred shall be measured at the fair value of the obligation taken on by making the award. That deferred revenue should then be recognised based on the number of awards that have been redeemed relative to the number expected to be redeemed.

EFRAG discussed these proposals and agreed that an interpretation is needed, because currently there is a divergence in practice and the amounts involved can be very significant. It did not however support the proposal that the deferral method should be used, with some members questioning whether the transaction is a multiple element arrangement and suggesting instead that in substance the award was a marketing expense and some members questioning whether the application of a deferral method to many of the schemes currently in existence would meet the cost-benefit test. A number of detailed comments were also made.

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A draft EFRAG comment letter is now being prepared and will be issued on EFRAG's website (www.efrag.org) towards the end of the month.

EFRAG has recently announced that it is setting up an **EFRAG User Panel** to assist it in its work. The Panel will provide EFRAG with input from the user community on EFRAG's comment letters and endorsement advice and on the long-term proactive work carried out by EFRAG itself and the projects carried out in connection with the Proactive Accounting Activities in Europe initiative. At its September meeting EFRAG discussed various procedural matters concerning arrangements for the Panel. EFRAG has recently issued a public invitation for candidates for its User Panel. Details are available from EFRAG's website (www.efrag.org).

At its July meeting, EFRAG discussed progress on the IFRIC project on Interim Financial Reporting and Impairment. At that time IFRIC had nearly finalised its Interpretation on the subject—it was issued shortly after EFRAG's meeting as **IFRIC 10 *Interim Financial Reporting and Impairment***—so EFRAG discussed the expected content of the Interpretation in order to prepare a draft endorsement advice letter.

After discussion, EFRAG had agreed that, subject to reviewing IFRIC 10, its draft advice would be to recommend endorsement. EFRAG had also considered whether the decision to use an IFRIC Interpretation to address a conflict between standards might have implications for the content of EFRAG's endorsement advice letter, but took no final decision on the matter.

At its September meeting, EFRAG considered the text of IFRIC 10 and reconfirmed the tentative decisions it had taken in July. It also agreed that a reference to the conflict between IAS 34 and IFRIC 10 should be included in the draft endorsement advice letter.

EFRAG's draft endorsement letter has now been issued for comment and is available from EFRAG's website (www.efrag.org).

EFRAG also discussed **IFRIC D19 *IAS 19—The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements*** at its September meeting. The objective of this discussion was to develop a draft EFRAG comment letter on the draft Interpretation.

D19 clarifies when economic benefits in the form of a refund or reductions in future contributions to the plan may be considered 'available' under the asset ceiling test in IAS19.58. It also provides guidance on the effect of minimum funding requirements on the measurement of the (net) defined benefit asset or liability.

After discussion, EFRAG decided to support IFRIC's decision to develop an Interpretation on the issues. It also decided that it was broadly in agreement with the conclusions reached in the draft, although there were some detailed issues that it thought could be clarified. EFRAG's draft comment letter has now been issued for comment and is available from EFRAG's website (www.efrag.org).

At its July meeting EFRAG considered the first parts of **the IASB Discussion Paper on the Conceptual Framework**. At its September meeting it discussed the remainder (ie Chapter 2) of the Paper. The objective of these discussions is to develop a draft EFRAG comment letter that can be issued for comment by mid-September.

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.

Perhaps the most noticeable change proposed in Chapter 2 is the replacement of the qualitative characteristic of 'reliability' with 'faithful representation' (which was previously a sub-characteristic of 'reliability') and to introduce the notion of verifiability. Although the IASB argues in its paper that this is not a significant change, EFRAG members thought otherwise and raised a number of concerns about various aspects of the proposal. Some detailed concerns about other aspects of the chapter were also raised.

EFRAG's draft comment letter on the discussion paper will be issued in the next few days and will be available from EFRAG's website (www.efrag.org).

EFRAG discussed the briefing it should give its representatives at **the European Commission's Roundtable meetings**. It noted that it would usually be difficult, because of timing, for EFRAG to discuss the issues in full before the meetings. It might nevertheless be possible to develop some guidelines setting out the broad approach that EFRAG would wish to be adopted by its representatives during the Roundtable discussions. EFRAG agreed, for example, that it did not support the suggestion that IFRIC should address major issues—they should be dealt with through standards, not Interpretations—nor did it generally support requests for an additional layer of detailed implementation guidance.

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'.) Four PAAinE projects have now been started, and at its meeting in September EFRAG discussed two of them.

- **The PAAinE project on the Conceptual Framework.** This project is being led by staff of the French standard-setter (the CNC), who are preparing a Discussion Paper that is designed to provoke thought and debate within Europe on the following issues.
 - The objective(s) of the Framework, and the implications this has for its content.
 - The scope of the Framework—in other words, to which financial reports prepared by which types of entity should the Framework apply?
 - Whether a single set of financial statements can really meet most of the information needs of the users, and which category (categories) of users should be treated as the primary users.

In August, the CNC staff circulated a preliminary draft of the proposed Discussion Paper to EFRAG and all European national standard-setters for comment. At its September meeting EFRAG discussed that preliminary draft and made various suggestions as to how it might be developed to make it as useful as possible.

- **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 a paper that explains briefly the issues and points-of-view underlying the debate currently taking place on the need for fundamental changes in the way that entities present information about their financial performance. 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 **11 October to 13 October 2006** in Brussels. On the first day, EFRAG will meet with the European National Standard-Setters.

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