EFRAG

European Financial Reporting Advisory Group

December 2012

EFRAG – IASB joint meeting

EFRAG - IASB Joint Meeting held on 18 December 2012

Summary of main messages expressed by the EFRAG delegation

EFRAG and IASB had one of their regular joint public meetings on 18 December 2012. The EFRAG delegation was composed of the EFRAG Chairman (Françoise Flores), EFRAG TEG member Nicklas Grip, the Chairman of the FRC's Accounting Council (Roger Marshall), the President of the ASCG (Liesel Knorr), the Chairman of the ANC (Jérôme Haas) and the vice-chairman of the OIC (Alberto Giussani) accompanied by their Technical Directors or a member of their Boards. IASB was represented by Hans Hoogervorst, IASB Chairman, Ian Mackintosh, Vice-Chairman, Philippe Danjou, Stephen Cooper, Amoros Gomez, Pat Finnegan, Pat McConnell, Takatsugu Ochi, Jan Engström and Martin Edelmann, IASB members, assisted by IASB senior staff.

The meeting was the opportunity to exchange information and views more particularly in relation to the IASB current work programme including results from post-implementation reviews and how EFRAG and NSS in Europe would like to contribute to the revision of the IFRS Conceptual Framework.

Leases

We support the objective of the IASB to recognise lease financing liabilities on the balance sheet. We welcome, for the first time in this project, the project's objective (Speech by Hans Hoogervoorst on 6 November). Each decision in the project should be assessed against this objective together with the costs/benefit that are paramount to this project.

The EFRAG's response to the first ED supported the right of use model provided that no service contract would be scoped in. We acknowledge that the IASB has reworked the definition of a lease. This definition needs to be tested in practice to ensure that it can be applied in a consistent manner, not be open to interpretation and that no service or non-financing contract would be scoped in. Such field testing should be the opportunity to verify that proposed requirements are consistent with the project's objective and that they do not bring undue complexity or unreasonable cost.

Distinguishing between leases of assets and services requires judgement, we believe that the standard should adopt a restrictive approach to avoid bringing many service contracts rather than just lease financing liabilities on to the balance sheet. There may be room to assess the contract as a whole, to best depict whether it is akin to a financing arrangement or a service contract. Where the IASB may have concerns of structuring opportunities, it should give elements of guidance as to how exercise

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judgement (so that it can be exercised genuinely), however not define anti-avoidance clauses that lead to different reporting outcomes than those consistent with the objective of the project.

Financial instruments

Classification and Measurement – recent ED

We will provide our full comments on the recent ED in due course.

In the meantime we note that the amendments bring helpful clarifications to avoid overly restrictive interpretations, but lead to no relaxation of the characteristics of the instrument test. The consequence is that instruments that would be commonly assessed as containing no leverage, such as for example financial instruments with regulated interest rate, would still often be required to be measured at fair value through profit or loss, although they are held for collection of contractual cash flows.

EFRAG appreciates that the IASB has considered its “principal and interest bifurcation approach” as duly reflected in the basis for conclusions, although it has been rejected at the exposure draft stage. While EFRAG continues to believe in the relevance of this approach and in its consistency with IFRS 9 principles, its aim at this stage is to help the IASB complete its IFRS 9 project swiftly, in such a way that the final standard can be assessed as bringing necessary improvements to financial instrument accounting. As we know one of the most critical areas is whether the basis to require amortised cost or fair value is sound. EFRAG and its partners in the survey, among which some NSS, are about to launch a survey to assess the effects of the change from IAS 39 to IFRS 9. We would like to conduct this survey in coordination with the IASB.

The exposure draft proposes also the acknowledgement of a third business model, holding to collect or sale. EFRAG and its partners welcome the IASB’s efforts to follow up on their recommendation to carefully consider the interrelations between insurance contract and financial instrument accounting. As indicating above, our comments will be provided in due course.

Impairment of financial assets

We reaffirm our past position that the final impairment model should reflect the accounting for both the expected losses associated with the recognition of interest income and credit losses arising from the deterioration of credit after inception. EFRAG would however not wish to recommend any particular approach. We acknowledge that the IASB has had to develop practical expedients and shortcuts to mitigate operational difficulties, however, any eventual model has to be a justifiable practical expedient to comply with the above criteria.

General Hedge Accounting Review Draft

We have now completed our field test on the Review Draft and the experience has convinced us further that this due process step is essential.

A certain number of implementation difficulties have been identified, which include the treatment of basis risk in cross currency interest rate swaps, the complexity and the resulting uncertainty that arises more particularly from how the hedge ratio and ineffectiveness should be determined or the limitations applicable to hedged items and hedging instruments, or the complexity inherent to the treatment of time value and forward points. EFRAG believe that these issues require the IASB's attention.

The field test shows that the new requirements are particularly effective when derivatives are part of aggregated exposures, for separate identification of risk components, to identify a group of items as the hedged item, or in the use of options and forward contracts as hedging instruments.

Participants in the field test have however stressed the inconvenience of the final requirements' limitations to reflect their hedging strategies. EFRAG acknowledges that these limitations have all been considered as part of the IASB's due process. We therefore believe that they should receive particular attention in the assessment of whether the final standard meets its objective of better alignment, for the benefits of users, of hedge accounting and hedging strategies. Where limitations remain that leave out common significant hedging strategies from hedge accounting, they need to be fully justified and understood. The current basis for conclusions is not necessarily particularly convincing from this perspective, notably when considering the limitations to hedging of credit risk, sub-Libor and the treatment of foreign currency risk compared to other risk components. The reference to possible "unintended consequences" does not seem enough substantiated.

Finally, and although overall views vary on this issue, many constituents more particularly in the financial sector have expressed the need to consider IFRS 9 as a whole (classification and measurement and impairment in addition to general hedge accounting requirements) prior to the publication of the final requirements.

Coexistence of IFRS 9 and IAS 39 macro-hedging requirements

The analysis conducted by our staff on the basis of the intended consequential amendments to IAS 39 has led to the tentative conclusion that current macro-hedging practice, including the European carve-out, could be retained. However we believe that practitioners should be given the opportunity to assess this point prior to the final general hedge accounting requirements being published. As the IASB well understands this is an area of particular concern from a European perspective.

Effective date

The current work programme of the IASB seems to invalidate IFRS 9 effective date maintained as of 1January 2015. This is an area of particular concern in practice.

We remind the IASB of our recommendation that IFRS 4 and IFRS 9 mandatory dates should be aligned.

Insurance contracts

We are satisfied that the IASB has decided to re-expose a certain number of decisions reached in its re-deliberations. We would like to assist the IASB in organising a field test of the re-exposure draft in close coordination with the IASB, National Standard Setters and the European Insurance Industry.

Discount rate in the measurement of pension liabilities

As the IASB is aware the reference to high quality corporate or government bond rates is problematic in a certain number of jurisdictions for the measurement of pension liabilities, given the recent market changes. We believe that IAS 19 should be amended to clarify the discount rate that should be used in changing market conditions. The amendment should consider the disclosure requirements regarding the discount rate.

How to apply IFRS 11 in the separate financial statements

Shortly after IFRS 11 was published, we conveyed to the IASB the concerns of those in Europe who apply IFRS to separate financial statements. We envisaged that the IASB would issue an amendment to deal with this unintended consequence but note, with disappointment; there has been no progress on this matter.

We welcome current IASB standard setting efforts related to separate financial statements.

Post-implementation review of IFRS 8

From the perspective of IFRS 8, the conclusion that could be derived from the input we have received would be that the management approach adopted in IFRS 8 is satisfactory. However that some implementation issues have arisen – already identified in the review conducted by ESMA end of 2011 -, that suggest that a limited maintenance effort of the standard could increase the usefulness of the information provided and the reliance that users should gain on the operating segment information.

In respect to due process, we believe that the coordination and cooperation between the IASB and EFRAG and NSS in Europe has worked well and should be maintained in the future.

We also would recommend the IASB to leave aside the assessment of whether changes have led to an improvement (we are not trying to assess the performance of the IASB) and rather concentrate on whether the current mandatory requirements are satisfactory in practice.

We note that the post-implementation review of IFRS 3 may be more challenging however, and that the definition of its scope will be critical, as it may raise the need to review related aspects of IAS 36 *Impairment of non-financial assets* and IAS 38 *Intangibles.*

Survey on the subsequent measurement of goodwill

As the IASB is aware, OIC and EFRAG decided to launch a survey considering more particularly the issue of subsequent measurement of goodwill. Results of the survey will be communicated to the IASB to contribute to the definition of the scope of IFRS 3 post-implementation review.

Revision of the conceptual framework

We welcome the IASB's efforts to revise the conceptual framework and to give to this project highest priority. This is from our point of view the most important development in financial reporting since the adoption of IFRS for use in Europe. We therefore intend to be very proactive in contributing to the IASB's efforts, and help our constituents to participate as widely as possible, so as to have European views well heard in the debate.

We will initially contribute to the debate in the following subjects:

- The role stewardship should play in the development of financial reporting standards;
- Performance reporting, including the use of comprehensive income;
- The appropriate emphasis on the importance of prudence and reliability;

- The need, if any, for recognition criteria;
- The appropriate guidelines for the selection of required measurement attributes; and

as a result of our joint proactive projects below.

Joint proactive projects contributing to the revision of the conceptual framework

Our discussion of the role that the business model should play and the progress made in our project on how capital providers use financial statements should also be important contributions to the revision of the conceptual framework.

Last but not least, we expect to prepare a feedback statement following comments received on our joint EFRAG/ ANC/ FRC paper on the Disclosure Framework to the Notes. We welcome the IASB's actions to commence the development of a disclosure framework and recommend the principles should be applied to the development of disclosures at standard level, including current projects. There is a high demand for improvement in this area and the standard setting effort at standard level cannot be delayed up to after the conceptual framework is revised.