EFRAG
European Financial Reporting Advisory Group

EFRAG TEG *UPDATE* APRIL 2007

Summary of the EFRAG TEG meeting in April 2007

On Wednesday 25 April to Friday 27 April 2007 EFRAG held its monthly meeting and discussed:

- The Amendment to IAS 23 *Borrowing Costs*
- The Amendment to IFRS 2 *Vesting Conditions and Cancellations*
- The Amendment to IAS 1 resulting from Phase A of the IASB project on Financial Statement Presentation
- IASB *Fair Value Measurements* Discussion paper
- IASB project on Business Combinations
- IASB ED of Amendments to IFRS 1 and the Cost of an Investment in a Subsidiary
- IASB Framework project on the Reporting Entity
- IASB project on Equity/Liability classification
- PAAinE project on Stewardship

For several meetings now, EFRAG has been discussing its draft endorsement advice on the recent **Amendments to IAS 23 *Borrowing Costs***. EFRAG had been very critical when the IASB had issued its proposed amendments in 2006, but the IASB decided not to make any significant changes in finalising the amendments. The main amendment therefore is to eliminate the immediate expensing option, thus making it a requirement that entities capitalise borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset as part of that asset. EFRAG staff presented a draft endorsement letter recommending endorsement and a draft basis for conclusions explaining that some EFRAG members were concerned that, because the benefits resulting from the amendment appeared not to be significant, the cost/benefit test might not be met.
The draft endorsement letter is available from EFRAG's website (www.efrag.org). Comments on the draft are invited by 25 May 2007.

The IASB is getting close to finalising its **Amendment to IFRS 2 *Vesting Conditions and Cancellations*** and, as a result, EFRAG has started to consider the endorsement advice it should give on the Amendment. It had an initial discussion at its March meeting, and identified a number of issues that could perhaps be clarified. (These issues have since been brought to the attention of the IASB staff.) At the April meeting EFRAG considered the Amendment further. It also considered an initial draft of a letter recommending endorsement.
EFRAG members highlighted a number of potential concerns about the Amendment. For example, some members thought the Amendment had the effect of making IFRS 2 more rule-based. Some were not convinced that the Amendment, though clarifying how the standard should be applied and therefore likely to result in greater consistency, would result in an improvement in accounting overall. It was nevertheless agreed that EFRAG staff should continue to work on developing a draft letter recommending endorsement. EFRAG members also made various comments on how the initial draft letter could be improved.
EFRAG will discuss this issue further as the IASB finalises and issues the Amendment.

EFRAG also had its first discussion about the endorsement advice it might give on the **Amendment to IAS 1 resulting from Phase A of the IASB project on Financial Statement Presentation**. Several issues that might benefit from clarification were identified, and EFRAG staff was asked to bring them to the attention of IASB staff.

- EFRAG members were broadly supportive about some aspects of the Amendment including, for example, the requirement to present changes in equity arising from transactions with owners as owners (for example, dividends and capital injections) separately from other changes in equity and the requirement to highlight recycling adjustments. EFRAG members also supported the IASB's decision to allow companies to present non-owner changes in equity in two statements.
- EFRAG members were less supportive of some other aspects of the Amendment including, for example, the change (that preparers do not need to adopt) to the names of the primary financial statements.
- EFRAG members generally did not support the IASB's decision to require separate disclosure of the income tax relating to each component of other comprehensive income. They thought that, because of the degree of judgement involved and the interaction between the different items, the numbers would be rather arbitrary and therefore not helpful.

Concerns were also raised about the timing and the consequential changes resulting from the IASB's decision at the beginning of the project to split it into two phases. After further discussion, EFRAG asked the staff to prepare for EFRAG's consideration a draft letter recommending endorsement.

At the April meeting EFRAG also considered the letters in received in response to its draft comment letter on **the IASB *Fair Value Measurements* Discussion Paper**. EFRAG concluded that the letters received broadly supported the messages set out in EFRAG's draft letter, and that therefore there should not be any major changes to those messages. However various detailed changes to the draft were agreed. It is expected that the letter will be finalised and issued towards the end of May, at which time it will be available from EFRAG's website (www.efrag.org).

EFRAG also discussed recent developments in the **IASB project on Business Combinations**. In particular, it discussed the IASB's recent decision that, rather than require entities to measure non-controlling interests in subsidiaries (NCI) at fair value (the so-called 'full goodwill' approach), its new standard should allow entities a choice of fair valuing NCI or measuring it at the proportionate share of the identifiable net assets acquired. This choice could be exercised on an acquisition-by-acquisition basis. EFRAG members generally have not in the past supported the proposal to measure NCI at fair value. Therefore, the issue for those members is whether allowing a choice makes it possible for EFRAG to support the eventual standard.

- If the concern of EFRAG members was that requiring entities to fair value NCI meant requiring entities to incur additional costs without commensurate benefits, the IASB's decision to allow a choice would appear to address that concern—as long as those members consider the alternative allowed to be acceptable (a matter that was not being discussed at this meeting).
- On the other hand, if the concern was that fair valuing NCI was inappropriate accounting, allowing a choice would not help very much because entities were free to adopt inappropriate accounting. EFRAG members had different views on this issue.

Another concern for some EFRAG members was the IASB's overall approach to options. EFRAG's general view is that standards are better if they do not contain options, because options affect comparability. However, some EFRAG members believe the IASB is sending a confusing message to its constituents about options: on the one hand it is in this project introducing an option to allow those entities that wish to converge to US practice to do so; whilst in other projects

(for example IAS 23 *Borrowing Costs*) an option to converge is not deemed sufficient so an option is being eliminated to force all entities to converge.
EFRAG did not take any decisions on the issues discussed and will continue its discussion at future meetings.

At its April meeting, EFRAG also considered the comments it received in response to its draft comment letter on the **ED of Amendments to IFRS 1 *Cost of an Investment in a Subsidiary*** in order to finalise its comment letter. One of the main proposals in the ED concerns the requirement in IFRS 1 for entities adopting IFRS for the first time to measure their investments in subsidiaries in their individual financial statements at either cost or fair value. The ED proposes that relief should be available in determining 'cost'. In its draft letter, EFRAG generally supported the ED's proposals. It did argue though that the range of reliefs available should be extended to include the amount calculated using the equity method at the date of transition.
Various changes to the draft letter were agreed and EFRAG staff was asked to prepare a revised draft for consideration at the next EFRAG meeting.

EFRAG also discussed the **IASB Framework project on the Reporting Entity**. It is expected that the IASB will issue a discussion paper on the subject in the summer and the purpose of EFRAG's discussion was to start developing views for inclusion in EFRAG's draft comment letter.

Two groups of issues were discussed:

- The relationship between the parent entity and the group entity, in particular whether the consolidated financial statements are the financial statements of the parent or of the group. And, if the answer is they are the financial statements of the parent, what do the individual financial statements of the parent represent—can one entity have two sets of general purpose financial statements?. And what do the financial statements of other entities in the group represent—is a subsidiary a separate reporting entity?
- Whether the concept of control should be used more or less in the way it is now to determine the composition of the group; in particular, whether it might sometimes or always be appropriate to define a group as entities that are under the common control of an entity that is not part of the group.

Different views were expressed and no decisions were taken. This discussion will continue as the IASB's work continues.

EFRAG also participated in an educational session about the work being undertaken in the **IASB project on Equity/Liability classification**. FASB is expected in Quarter 3 to issue a preliminary views document describing three possible classification systems, and the IASB is intending to incorporate that FASB document in an IASB Discussion Paper. The objective of the session was to help EFRAG members to understand better the three FASB classification systems.
EFRAG also received feedback on the session at the joint IASB/FASB meeting at which the PAAinE thinking on this subject—the so-called 'loss absorption approach'—was discussed.

EFRAG considered a proposal to undertake a very short-term **PAAinE project on Stewardship**. The objective of the work would be to develop a common understanding of what the notion meant and what would be the implications for IFRS of incorporating in the Framework as an objective of financial reporting a separate stewardship objective. EFRAG agreed that such a project should be undertaken.

EFRAG will hold its next meeting in Brussels on **Wednesday 30 May through to Friday 1 June. EFRAG meetings are held in public.** Those wishing to observe some or all of the meeting should contact Nathalie Saintmard on info@efrag.org.

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