



## Convergence discussions with the IASB

### Introduction

On 17 April, an EFRAG delegation (which will include the Chairs of EFRAG and of the French, German and UK standard-setters) will meet with representatives of the IASB to discuss the IASB's US convergence work. The issues that the EFRAG delegation has asked to discuss are set out below.

### User needs

- 1 As the objective of financial reporting is to provide information that is useful to users of those reports, what users think about proposals etc is very important—yet the user community has historically not been very good at organising itself in a way that enables its views to be heard.
  - (a) We would like to discuss with IASB representatives the ways in which the IASB is currently getting input from users and what if any plans are in place to enhance those arrangements.
  - (b) As with other sectors of the financial reporting community, users often do not speak with one voice. We would like to discuss what can we do to reconcile the different messages we get from users.
- 2 We would also like to discuss what messages the IASB is getting from users on reporting financial performance.

### Income tax

- 3 We would welcome an update on the Income Taxes project. We would in particular like to understand the reasons for the delay and the issues that remain to be resolved.

### Post-retirement benefits (including pensions)

- 4 Our understanding is that, although the long-term objective of the IASB and FASB is to have a converged standard on Post-retirement Benefits, both Boards are for the time been carrying out separate projects. We are concerned in case this means change after change after change in this area, and would therefore like to understand better how the IASB envisages that convergence will be achieved on the issue.

### **Revenue Recognition**

- 5 The IASB and FASB have a joint project on revenue recognition, and so does the PAAinE. We thought it would be helpful to briefly update each other on our projects. It would be particularly helpful if, in the update on the IASB project, the IASB representatives could explain how they believe the project is likely to unfold and could give an assessment of the positions of each of the Boards.

### **Constructive obligations**

- 6 The IASB and FASB both have projects on liabilities and, although the projects are not part of the convergence agenda, it has looked as if the projects would achieve a fair degree of convergence on, inter alia, constructive obligations. However, that notion is being re-examined in other projects (for example insurance). We would welcome an explanation from the IASB representatives on how the IASB intends to manage the links between these projects.

### **Equity/liability classification**

- 7 We would like to take the opportunity at this meeting to emphasise again the importance to Europe (and for the increased use of IFRS in Europe) of IFRS adopting a satisfactory approach to equity/liability classification, and the concerns that we have with the existing approach in IAS 32.
- 8 Aware of the linkage that exists between this issue and other projects—such as the definition of the elements of financial statements—we would also encourage the IASB not to conclude on those related issues in a way that limits the IASB's ability to find the right approach to equity/liability classification.

### **Business combinations**

- 9 We would be interested in being updated on where the IASB thinks it has got to on Business Combinations and where it might go from here. A comparison to FASB's position would also be welcome. Although we have a number of concerns about the proposals in this area, we would like to drill down into just the following issues at this meeting.
  - (a) Our understanding is that the IASB has tentatively agreed that the principle should be that NCI should be fair valued. It would help us if the IASB representatives could explain why most members believe the usefulness of the information is enhanced by adopting that principle. Is it the IASB's understanding that users support this reasoning?
  - (b) What are the implications of the IASB and FASB not agreeing on how to treat NCI/goodwill?
- 10 We would also like to understand whether the intention is to have further phases in this project and, if it is, when those phases will be undertaken and what they will involve. We are particularly interested in the IASB's plans for business combinations involving entities under common control.

## **Conceptual Framework**

- 11 Although we have a number of concerns about last year's Framework DP, we would today just like to discuss two potential concerns we have about process.

*When should an exposure draft be issued?*

- 12 We believe that it is essential for the success of the IFRS project that the IASB, FASB and their constituents have a shared vision of accounting, and we also believe that, if we are to have that shared vision, it is essential that the Boards give themselves time to fully explore and understand the concerns that have been raised in response to the DP. Issues that we think are particularly worthy of further consideration and debate include:

- (a) The statements that are made in the proposed new Framework about user needs and how they can best be satisfied.
- (b) Stewardship and the objective of financial statements.
- (c) The debate about reliability v faithful representation, and the meaning of notions such as 'faithful representation' and 'substance'.

For that reason we are not in favour of issuing an exposure draft in the near future.

*When should chapters one and two be finalised?*

- 13 We think it would be best if no sections of the Framework were finalised until the whole of the Framework is ready to be finalised.

## **Fair value measurement guidance/Measurement generally**

- 14 We would hope that the global, comprehensive measurement debate that has now started will be successful and conclusive. We wish to discuss a couple of issues with the IASB representatives which we believe are central to such an outcome.

*What does the relevance criteria mean in the context of measurement?*

- 15 Different current value systems result in different gains and losses being recognised at different points in the transaction cycle, and therefore provide different views of the financial performance of the reporting entity. EFRAG has argued in the past that it follows from this that decisions should not be taken about the measurement basis or bases to be used in the financial statements until we have decided what view of financial performance and financial position we are trying to portray. In other words, one cannot apply the 'relevance' test without first establishing how the term should be understood at an operational level. Is that fair comment or, for example, do the IASB representatives believe the work has already been done?

- 16 Some commentators characterise the arguments currently advanced to support the use of a current market-based exit value version of fair value as follows:

The objective of financial statements is to provide users with information about future cash flows...

...and current value tells users more about future cash flows than historical cost measures.

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And a current exit value tells users more about future cash flows than a current entry value.

Subjectivity can be an issue with some forms of current value, so it is best to use as much observable data as possible.

That means using market-based exit value measures.

EFRAG has argued in the past that this is an over-simplification. For example, the value of an entity comes from its ability to generate net cash inflows—in other words the entity's ability to add value—and candidate measurement bases need to be judged in terms of the extent to which they improve users' assessments of that ability. Is that fair comment?

- 17 Many constituents believe the much of what the IASB says about measurement is based on the assumption that there is an active and liquid market that is in equilibrium. They argue that it is inappropriate to assume that, because in fact it is rarely the case and conclusions drawn when it is the case should not be applied in the absence of such markets. But is that what the IASB is doing?

*What does the reliability/faithful representation criteria mean in the context of measurement?*

- 18 There are a number of statements and hints in the Framework DP that suggest that the Boards believe that measurement bases that are not current values are poor at faithfully representing assets compared to current value measurement bases. (For example, the example in QC18 seems to imply that current value-based amounts are more faithfully representational than cost-based amounts. Similarly, the example in QC22 also criticises the use of cost.) Some commentators have significant problems with such statements, which suggests that there is currently no agreement on what the term means. There is a similar issue concerning the reliability qualitative characteristic. We think there needs to be agreement on a detailed level as to what exactly these notions mean before they can be applied in the measurement debate. Does the IASB agree and, if it does, how is the matter to be resolved?

### *Other issues*

- 19 We also have some questions about the Fair Value Measurements DP that we hope the IASB representatives will be able to answer,
- (a) The DP is a 'how to' paper, but what stage has the IASB reached in its 'when to' debate?
  - (b) Does the IASB intend to make clear its intentions on the 'when to' issue before a 'how to' ED is issued?
  - (c) The objective of the DP is to "establish a single source of guidance for all fair value measurements required by IFRS". As 'fair value' is a generic term that is used to describe a family of measurement bases, does that mean that the IASB intends to develop equally detailed guidance on the other members of the fair value family?
  - (a) How does the IASB intend to manage the links between the Framework project on Measurement and the Fair Value Measurement project? For example, if the Framework project is not going to be finished for many years,

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what criteria will the IASB use to reach its 'when to' decisions in its Fair Value Measurement project?

### **How can we help the IASB in its convergence work?**

- 20 Currently EFRAG and Europe generally participate in the IASB's work mainly through submitting comment letters and periodically meeting with IASB representatives to exchange information and express views. Is anything more Europe could usefully do to participate constructively in the debate?

### **Other IASB/FASB convergence projects**

- 21 Attached to this note is a schedule showing EFRAG staff's estimate of the progress made by the IASB and FASB towards achieving the 'Roadmap goals'. We would like the IASB representatives if possible to update us briefly on the timetable for the projects that are either not on target (ie those with a cross in the right hand column) and those where EFRAG staff was not sure what the current position is (ie those with a question mark in the right hand column).

**Observer note for meeting of IASB and EFRAG representatives on Tuesday 17 April 2007**

**EFRAG staff's estimate of the progress made by the IASB and FASB towards the 'Roadmap goals'** (30 March draft)

- 1 By end of 2007 to (a) reach a conclusion about whether major differences in the following few focused areas should be eliminated and (b) (if so) complete or substantially complete work in those areas.

<i>Project</i>	<i>Responsibility</i>	<i>Progress</i>	<i>On target to meet Roadmap?</i>
Borrowing costs	IASB	Expected to be completed in March.	✓ (Already achieved)
Fair value option (including Investment Properties)	FASB	Completed	✓ (Already achieved)
Government grants	IASB	Although no work is being carried out at the moment, the IASB expect to resume work later this year and issue an ED before the end of the year. That implies a standard around the end of 2008.	* (Standard not expected until end of 2008.)
Impairment	Joint	It is expected that the results of initial staff research will be considered in the Spring and a decision taken as to whether to eliminate the differences taken then.	?
Income tax	Joint	ED has been much delayed, because of delays at FASB's end. Current IASB estimate is Q2 2007, which would suggest that a standard will be issued around the end of 2008.	* (Standard not expected until end of 2008.)
Joint ventures	IASB	An ED is expected in Q2 2007 and an IFRS in first half of 2008.	* (Standard not expected until mid-2008.)
Research and development	FASB	FASB has not yet issued an ED, and there appears to have been no work done on this project for at least six months. The target can now be met only if it is decided that the differences should not be eliminated.	?
Segment reporting	IASB	Completed	✓ (Already achieved)
Subsequent events	FASB	FASB has not yet issued an ED, and there appears to have been no work done on this project for a year. The target can now be met only if it is decided that the differences should not be eliminated.	?

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- 2 By end of 2007 to have made significant progress on joint projects in areas identified by both boards where current accounting practices of US GAAP and IFRSs are regarded as candidates for improvement. These are all supposed to be joint projects.

<b>Project</b>	<b>Target mentioned in the Roadmap</b>	<b>Progress</b>	<b>On target to meet Roadmap?</b>
Business combinations	To have issued converged standards.	The Boards think they will issue final standards in Summer 2007. This looks a bit optimistic, but nevertheless the deadline should not be a problem. It seems possible that the standards will not be identical, although it is likely that it will be possible to describe them as "substantially converged".	✓ (Substantially converged standards)
Consolidations	To implement work aimed at the completed development of converged standards as a matter of high priority.	The Boards think they will issue a discussion paper in Summer 2007. This is optimistic, but the Roadmap target should still be met comfortably.	✓ (Comfortably)
Derecognition	To have issued a due process document relating to the results of staff research efforts.	Some work has commenced. It is difficult to judge how far they will have got by the end of the year, but it ought to be possible to have issued by then some sort of due process document.	✓
Fair value measurement guidance	To have issued converged guidance.	FASB now have a standard. The IASB has recently issued a discussion paper, which means an ED in 2008 and a standard in 2009. There has been some slippage due to delays at FASB.	✗ (The IASB took a decision to introduce a DP stage, but there has been other slippage as well.)
Financial instruments	To have issued one or more due process documents.	Work underway and various tentative decisions taken. Some sort of due process document ought to be ready by the end of 2007.	✓
Intangible assets	To have considered the results of the IASB research project and made an agenda decision.	The current plan is to make an agenda decision in December 2007. This seems achievable, although it does depend on the speed at which the research project progresses and that is not entirely within the IASB's control.	✓ (Probably)
Leasing	To have considered the results of the IASB research project and made an agenda decision.	Research work has been going on for some time. The target ought to be achievable.	✓
Liabilities and equity distinction	To have issued one or more due process documents.	Currently FASB is expecting to issue a due process document in May, and the IASB shortly thereafter.	✓ (Comfortably)
Performance reporting	To have issued one or more due process documents on the full range of topics.	Currently the Boards expect to issue a due process document around the middle of 2007. This might be a bit optimistic, but it should still be achieved in 2007.	✓ (Comfortably)
Post-retirement benefits	To have issued one or more due process documents.	Work has only just commenced in the last few months. It is difficult to judge how far they will have got by the end of the year, but it ought to be possible to have issued by then some sort of due process document.	✓
Revenue Recognition	To have issued one or more due process documents.	This is a much-delayed project. Nevertheless, the Boards' expectation that it will be able to issue a discussion paper in the latter half of 2007 seems reasonable.	✓