ANNUAL REVIEW 2008

EFRAG OBJECTIVES

PRO-ACTIVE INPUT TO IASB AND IFRIC
ENDORSEMENT ADVICE TO THE EUROPEAN COMMISSION
PRO-ACTIVE ACCOUNTING ACTIVITIES IN EUROPE
ADVICE ON EU ACCOUNTING LEGISLATION

EFRAG
European Financial Reporting Advisory Group

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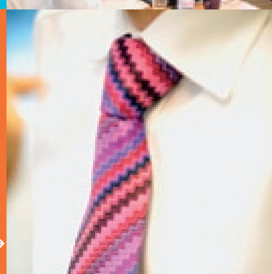


MESSAGE FROM THE CHAIRMAN OF THE SUPERVISORY BOARD

The year 2008 was very challenging for financial reporting standard setting around the globe. Looking at things as a whole, the year was dominated by what started as a US sub-prime crisis but became a deep and broadly-based worldwide economic crisis. Politicians came under severe pressure to act decisively both to address the effects of the crisis and to understand and tackle the causes of the crisis. According to some European stakeholders, accounting was at least partly to blame for the crisis and was also part of the solution, and as a result accounting has received much political attention over the last twelve months.

The accountability of standard setters in a more globalized world continued to be an important topic and focus was placed on the further enhancement of the governance of the International Accounting Standards Board (IASB). The US Securities and Exchange Commission (SEC) release of a proposal that US companies might move from US GAAP to IFRS in 2014 if further progress is made in convergence between the two sets of standards underlined the possibility of a new era and the need for buy-in at an early stage of the process of developing standards from all stakeholders around the world.

EFRAG in 2008 not only addressed the many financial reporting proposals and new standards issued by the IASB and continued with its proactive work but also engaged in an intense dialogue with the organisations representing stakeholders in financial reporting in Europe and the European Commission on how to further strengthen the resources of EFRAG in order to increase European proactive contributions to the IASB in developing IFRS and to strengthen the voice of Europe in the debate. I am pleased to report that the EFRAG General Assembly approved the enhancements to EFRAG, known informally as EFRAG Plus, in November 2008. The European Commission supported EFRAG Plus and has also proposed to make a significant contribution to the funding of additional staff resources.

Politicians in Europe have launched a number of urgent initiatives in response to the financial/economic crisis and as a result measures have been or are being taken in many areas of the economy. One of the concerns expressed about the existing accounting standards has been that aspects of them have a procyclical effect.

For example, the IASB's fair value accounting requirements have come under attack because they are seen as making the deterioration of the econo-

Göran Tidström
CHAIRMAN OF THE SUPERVISORY BOARD

my worse. Certain stakeholders believe that the effect has been to require banks to record losses in the short term arising from model-based valuations that will not be suffered in the longer term as the assets concerned are liquidated in an orderly manner rather than sold in illiquid markets, and that this is causing markets to deteriorate even further. They argue that fair value (or mark-to-market) accounting should not be used in some circumstances, and that standards should be amended accordingly.

The IASB has probably moved too far in the direction of fair value without first obtaining support for that direction, particularly within Europe.

In response to this criticism, the IASB issued an amendment to IAS 39 in October 2008 that meant that the losses that would otherwise have been recognised on certain financial instruments in the 3rd quarter of 2008 did not need to be reported. The amendment was issued by the IASB without due process and the EC stood ready to endorse immediately provided that it received positive endorsement advice from EFRAG. The Supervisory Board gave permission to the EFRAG Technical Experts Group (TEG) to issue endorsement advice without the normal due process.
The SB gave its permission on the basis that this was a very rare exception in extremely unusual circumstances.

Closer to home, as noted above, in 2008 we initiated what we called "EFRAG Plus" – a further strengthening of EFRAG. The SB issued a proposal on the strengthening of EFRAG for public comment over the summer. The objective of the proposals is to strengthen EFRAG as the European voice of accounting, to enable EFRAG to work even more closely with the European national standard setters (NSS) that possess strong technical resources and to enhance EFRAG's independence by increasing the public accountability of the SB. The end result should be a significant increase in EFRAG's resources and greater involvement by the NSS in setting the agenda for proactive work in Europe on account-

ing, both of which should make it possible for EFRAG on Europe's behalf to be more involved in the debate that takes place as the IASB formulates its views on issues and before the IASB issues its discussion papers. The strengthening will also help ensure that Europe maintains and if possible enhances its thought leadership ability.

The SB held a number of meetings in 2008 to develop the EFRAG Plus proposals, and there were also several meetings with NSS to agree the way forward.
We received many comment letters in response to the enhancement proposals and there was a strong level of support for the proposals. The SB prepared its final report on enhancement in the light of the comments received and published a feed-back statement with its final report in December.
We have now started to implement the proposals. In particular, we are inviting candidates for members of the new Supervisory Board and will shortly be appointing, as an interim measure, a 'temporary' Planning & Resource Committee to enable the proactive work to continue. We have also finalised memoranda of understanding with three major NSS who have undertaken to commit resources to the proactive work jointly with EFRAG. We have also begun the process of recruiting additional technical staff. EFRAG has in the past been able to attract good candidates for technical staff, and the recent enhancements to EFRAG will make it an even more interesting and challenging place in which to work.
EFRAG also moved to new and larger offices on 1st January 2009 to enable the enhanced structure to be implemented.

EFRAG has always been close to the European Commission because of its role in advising the Commission on accounting matters, and we appreciate that close relationship. The EC always has been aware of the importance of ensuring that EFRAG can be its independent advisor, that EFRAG has the strength and resources to operate effectively, and that EFRAG has the principal European relationship with the IASB on technical issues. We are grateful for the continued support.

The Supervisory Board follows closely the development of the work of the TEG based on regular reports from the Chairman of the TEG. Other key areas for the SB are the evaluation of the work of the members of the TEG, appointment/reappointment of TEG members and funding of EFRAG and the SB will enhance its procedures in these areas under the enhanced EFRAG arrangements.

The base funding of EFRAG is provided by the European organisations that stand behind EFRAG. Contributions to the additional funding that is required for EFRAG to increase its effectiveness have been provided by national funding mechanisms in a number but far from all Member States. The Supervisory Board and the European organisations have continued to encourage the creation of such mechanisms in all member states of the EU. Although several of the larger economies have agreed to bear their share of the funding responsibility, progress still needs to be made in many member states. The EC proposal to contribute up to 50 % of the total costs of EFRAG, when implemented, will significantly strengthen the credibility and resources of EFRAG and will create a sound balance in the funding between the European organisations, National Funding Mechanisms (when fully in place) and the EC.

The new EFRAG structure also means that this will be my last report as chairman of the Supervisory Board. It has been a great pleasure to be part of the formation of EFRAG back in 2001, to see it gradually develop as planned and to see it find its role as an important part of the global standard-setting architecture, supporting the IASB and the European community to improve financial reporting and to ensure a credible accounting framework for users, preparers, the audit profession and other stakeholders in IFRS.

Finally, I would like to express my appreciation for the hard work performed by the other members of the SB; by members of EFRAG TEG and its User Panel, working groups, the advisory panels on the proactive work; by EFRAG's representatives on the various IASB advisory groups and, last but certainly not least, by the EFRAG secretariat.

Göran Tidström
31 March 2009

ABOUT EFRAG

With the encouragement of the European Commission, EFRAG – the European Financial Reporting Advisory Group - was established in 2001 to provide input to the development of International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and to provide the European Commission with technical expertise and advice on the technical quality of International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). It is a private sector body established by European organisations prominent in European capital markets, known collectively as the "Founding Fathers" (see Table 1).

EFRAG's role as technical advisor to the European Commission is formalised in a "Working Arrangement" which states that "EFRAG will provide advice to the Commission on all issues relating to the application of IFRS in the EU", in particular proactive input to the IASB and endorsement advice.

The work of EFRAG is overseen by a Supervisory Board (SB) drawn from the Founding Fathers of EFRAG and is currently chaired by Göran Tidström, partner in PriceWaterhouseCoopers, Sweden. The European Commission is an observer at Supervisory Board meetings (see Table 2).

EFRAG operates through a Technical Expert Group (TEG). Its 11 members are drawn from throughout Europe and from a variety of backgrounds and devote 30% to 50% of their time – free of charge – to EFRAG. The Chairman, Stig Enevoldsen, partner in Deloitte, Denmark, is full time. The Chairs of the French, German and UK standard-setters are non-voting members of TEG. Further, The Committee of European Securities Regulators (CESR), the IASB and the European Commission attend TEG meetings as observers (see Table 3).

The members of EFRAG TEG are appointed by the SB, following an open call for candidates. The SB looks primarily to the knowledge and experience of candidates but also endeavours to achieve a broad geographical balance and a blend of experience from preparers, the accountancy profession, users of financial statements and academics, thereby ensuring that TEG's deliberations and its conclusions are independent and not unduly influenced by any interest group or constituency.

Members of TEG must not consider themselves as representing sectoral and/or national interests but should be guided by the need to act in the European interest.
EFRAG has established an open and transparent due process, which allows and encourages European constituents to provide input for consideration of EFRAG.

The transparency and independence of EFRAG TEG is mainly achieved by:

- having all technical discussions held in meetings open to the public;
- publication of TEG agendas and summary minutes of its meetings;
- publication, with an open call for comments, of draft EFRAG comment letters to the IASB, and draft effect study reports and draft endorsement advice letters to the European Commission;
- presentation of the basis for EFRAG TEG's conclusions for the endorsement advice and reasoned positions for comments sent to the IASB
- publication of final comment letters on IASB consultation documents, and other EFRAG positions; and
- publication of final endorsement advice letters and final effect study reports to the European Commission.

In addition, comment letters received are considered by EFRAG TEG and published on the EFRAG website.

EFRAG also works closely with European National Standard Setters (NSS), meeting with them every three months for a full day to obtain their input on comment letters, endorsement advice and other matters.

EFRAG maintains contact with the European Commission (EC) directly and through the Commission's role as observer at all EFRAG meetings. EFRAG is an official observer at the Accounting Regulatory Committee (ARC) and EFRAG is invited to attend some parts of the Standards Advice Review Group (SARG) meetings.

EFRAG maintains contact with the IASB through:

- regular meetings between the chairman of the IASB and the EFRAG TEG chairman;
- IASB board members attending monthly EFRAG meetings as observers;
- giving input to the IASB/FASB convergence agenda in special public meetings organised by the IASB;
- representatives of EFRAG participating in IASB working groups as observers (see Table 5);
- participation in the annual World Standard Setters meeting organised by the IASB.

EFRAG also meets the world's leading standard-setters twice a year in the Global Standard-Setters meeting.

An important objective for EFRAG has always been to provide proactive input to IASB consultative documents. By publishing draft comment letters early, EFRAG stimulates debate on the issues for comment and assists other bodies in Europe in developing their comment letters to the IASB.

EFRAG has established working groups to provide it with expert advice on specialist areas, such as financial instruments, insurance, joint venture accounting and SME accounting.
Reports of the working groups' activities are set out in this Annual Review.

It is also important to stimulate, carry out and manage proactive discussions on accounting issues so as to provide input to the IASB in the early phases of the IASB process. Therefore, EFRAG and the European NSS agreed in 2005 to work more closely together to this end through the Proactive Accounting Activities in Europe (PAAinE) initiative, to encourage debate in Europe and enhance the quality of Europe's input to the IASB.

The following projects were worked on in 2007 (each project is led by one standard setter, in some cases jointly with EFRAG):

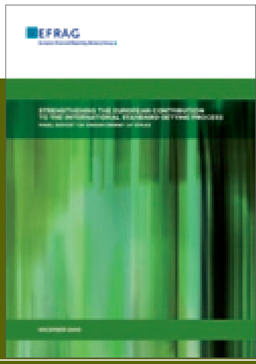
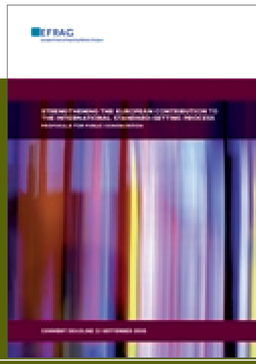
Each project is supported by a pan-European advisory group and also in most cases an advisory group from the country leading the work.

EFRAG's User Panel is an important part of EFRAG's due process. Its purpose is to ensure that broad input to EFRAG TEG is obtained from users. A report on the Panel's activities is given later in this Annual Review.

EFRAG's offices in Brussels are staffed by a secretariat which provides technical support for EFRAG TEG and for the EFRAG contribution to the PAAinE activities. The current staff is listed in Table 4.

EFRAG is funded by the Founding Fathers/Member body organisations supplemented by additional contributions from National Funding Mechanisms.

PROJECT	LED BY
The Conceptual Framework	France and EFRAG
Pensions	UK
Equity and Liabilities	Germany
Performance Reporting	Spain and EFRAG
Common Control Accounting	Italy and EFRAG
Income Tax	Germany and UK

EFRAG PLUS

In December EFRAG issued its report “Strengthening the European Contribution to the International Standard-Setting process”. The enhanced structure of EFRAG described in the report is designed to represent effectively all European stakeholders in IFRS. Key features of the enhanced structure include a substantial increase in the resources of the EFRAG secretariat, closer working with the European National Standard-Setters (NSS) that are committed to contribute significant resources and expertise to proactive projects, and increased funding contributions from National Funding Mechanisms, with public funding matching the funding provided by the Founding Fathers and the National Funding Mechanisms.

The Supervisory Board (SB) will comprise 17 members with an appropriate balance of professional backgrounds, including users, preparers and accountants. Four members of the SB will have a background with experience of public policy, either at national or European level. The SB will no longer comprise representatives of the founding fathers. The European Commission and CESR will be observers.

SB members will be required to commit themselves formally to acting in the European public interest, independent of their professional or sector affiliation. SB meetings will be open to the public.

The SB will appoint a Planning and Resource Committee (PRC). Its role will be - amongst others - to set the agenda for the proactive work that results in the issuance of discussion papers and other outputs. The PRC will provide guidance on the allocation of resources from EFRAG and the NSS to proactive projects and will monitor the progress of the work concerned.

The PRC will include the chair of EFRAG TEG and four senior representatives (normally the chairmen) of those NSS that have committed to provide resources to the proactive work. Two members of the PRC will be drawn from the SB and there will be two further members who have other professional backgrounds or alternatively could be members of the SB.

The work of the PRC will be supported by an informal Coordination Group that will act as a sounding board advising on potential proactive projects. The members will consist of NSS that are prepared to provide resources to and other input to the proactive work of EFRAG.

A high level Consultative Group will be established to provide strategic input into to the work of EFRAG.

REPORT OF THE CHAIRMAN OF THE TECHNICAL EXPERT GROUP

MOVING TOWARDS ONE GLOBAL ACCOUNTING LANGUAGE - US AND JAPAN HAVE ISSUED ROADMAPS THAT COULD LEAD TO THE ADOPTION OF IFRS

The vision of having a single global accounting language is still strong and alive in the midst of the financial crisis. It has been given impetus by the **US SEC's** issuance of its **Proposal Release** with a roadmap for a potential move towards the use of IFRS in the US from 2014, with a final decision to be taken in 2011. In addition the signals coming from the US FASB have been positive for a move towards adoption of IFRS. Furthermore it is very positive that **Japan has also issued a roadmap** with the same objective. If Europe, the US, Japan, Australia and those committed to implement IFRS - Canada, Brazil and South Korea - were to use the same accounting standards we would in reality have achieved the vision of one global accounting language. However, the SEC roadmap contains some qualifications and conditions that could be used to delay the adoption of IFRS. We saw how much opposition we had to the adoption of IFRS in Europe – and still have – so there are still obstacles to be overcome, but if anyone had said two years ago that the SEC would issue the Proposal Release in 2008, no-one would have believed it. The Proposal Release is therefore a very positive step forward, even though some sense in the present situation a slightly more hesitant attitude with the new US administration. We will work with the IASB to support it in its efforts to encourage the US to adopt IFRS.

Europe should support IASB and not make more carve-outs

Another potential obstacle to achieving a single global accounting language might be our behaviour in Europe. If we do not strongly support the IASB or should we decide to make more carve-outs, the US and Japan might decide not to adopt a set of accounting standards that are not supported or properly used in Europe. We in Europe have the competitive advantage of already having invested resources in implementing IFRS, and we should not throw that away. However, there is a real risk that further international adoption of IFRS will be jeopardised if either we for political reasons decide to permit exceptions to IFRS through carve-outs or to change standards issued by the IASB, or if the IASB alienates important constituents by moving further towards full fair value. All parties need to strike a delicate balance and move carefully forward.

Stig Enevoldsen
EFRAG TEG CHAIRMAN

There is an increasing concern about the use of fair value

The financial crisis that accelerated during 2008 put the spotlight on to accounting and gave rise to concerns that it had the effect of magnifying the crisis due to the fair value measurement of financial assets and in particular the fair value measurement of assets in illiquid markets. As many markets became illiquid in 2008 **criticism of the use of fair value** increased, because many bankers believed that their assets were undervalued, and that they would not realise their assets at the "market price". Even strong supporters of fair value amongst users had second thoughts and considered whether some other measurement basis would be more appropriate. Politicians and some bankers also expressed concern and became more vocal, and concerns about reporting results based on a theoretical market price developed into a strong demand for immediate change to the standards. Until that point in time the IASB had not been responding with sufficient urgency to the growing crisis but as from October the IASB showed far greater commitment to respond swiftly and effectively to the challenges.

The IASB issued the reclassification amendment without due process. We responded by issuing endorsement advice also without due process and the amendment was endorsed and published just three days after its issuance. This was an admirable concerted effort by all parties involved. EFRAG does not support the practice of amending standards without proper due process but we acknowledge that in the exceptional conditions of 2008, urgent action was needed in relation to certain financial reporting matters in order to stem the loss of confidence in the global financial markets.

EFRAG DOES NOT SUPPORT STANDARDS BEING ISSUED WITHOUT DUE PROCESS

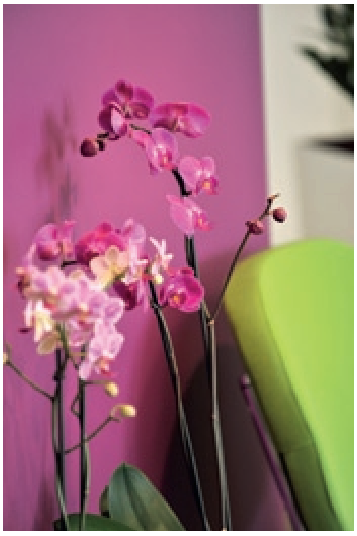
Subsequently to the amendment of IAS 39 to permit reclassification of certain financial assets in certain circumstances, the IASB has continued to work quickly on further amendments to IAS 39 and has issued exposure drafts on disclosures and an ED on consolidation, and they should be congratulated for that. Having said that, it is important that the IASB finally launches a full public debate on the use of current values to ensure that its constituents agree on the direction to be taken in IFRS to measurement. The IASB should not require measurement to be based on fair value if this is not widely accepted, as this could create strong forces in Europe in favour of abandoning IFRS.

IASB SHOULD START A COMPREHENSIVE DEBATE ON MEASUREMENT OF FINANCIAL INSTRUMENTS

A lesson learned from the amendment to IAS 39 made in October 2008 is that making changes to standards without adequate comment periods is not appropriate and creates bad standards that need further amendment. Appropriate due process must be followed in order to ensure that the output is high quality standards which achieve their intended objectives.

The FASB staff has recently issued proposals to abandon fair value in certain cases of distressed markets, with a comment period of only 15 days, and the IASB has issued an invitation for comments on whether to go the same route. We have serious concerns about the issue of proposals such as this without a proper comment period. In addition the IASB/FASB's Financial Crisis Advisory Group recently invited comments on the crisis with a short comment period. It is important that the IASB and FASB do not get into the habit of making quick fixes and partial solutions and do not as a result find themselves drawn towards the lowest common denominator. It is also important that we learn lessons from the crisis. The IASB should, therefore, instead work on a slightly longer term project that looks properly – but expeditiously – at the problems and come up with solutions in the short to medium term.

WE MUST LEARN THE LESSONS FROM THE CRISIS



In the middle of the crisis it is very important to get the issues resolved expeditiously, but it also has to be remembered that there is a limit to the extent of the issues the IASB's constituents can cope with at any one time if they are to provide valuable input.

Europe should work on supporting the credibility of European accounting

For Europe, one of the objectives in implementing IFRS was to improve financial reporting to the benefit of our capital markets, and to improve the credibility of financial reporting in Europe. In the middle of the crisis it is important to keep in mind that we must strike a sensible balance between crisis handling and maintaining credible financial reporting in Europe. Otherwise the credibility of our financial reports might be undermined.

We must learn the lessons from the crisis and make the necessary changes to IAS 39 on financial instruments

Another lesson learned is that the accounting requirements for financial instruments and the use of fair value needs careful reconsideration, but that will take time, although the work should be carried out expeditiously. There are parts of the standard that need immediate consideration such as the impairment rules for available for sales assets and loan loss provisioning, but even that might take some time. The IASB's March 2008 Discussion Paper on simplifications to accounting for financial instruments included inappropriate limitations on the scope of the discussion such as the premise that the only long-term solution to the problem of measurement-related complexity lies in fair value measurement. Such a precondition places inappropriate limitations on the dialogue the IASB should have with its constituents.
The main theme is that we must learn the lessons from the crisis and react appropriately by making the necessary changes to the standards. Stereotype thinking should not be accepted and no stone should be left unturned in the search for appropriate accounting standards that will help to improve the efficiency and effectiveness of our capital markets.

EFRAG enhancement is in progress

EFRAG has been operating for close to eight years and the Technical Experts Group and the secretariat have continually improved the quality of their work. In addition, the secretariat has done more than one could reasonably expect on the commenting on IASB and IFRIC draft pronouncements and on endorsement advice including effect studies. In light of the crisis and in order to ensure stronger and more coordinated input to the IASB and to enhance the scope and quality of proactive work in Europe, the Supervisory Board developed and obtained general support for proposals to enhance the governance, organisation structure and operating procedures of EFRAG. On the technical level the enhancements will give us considerably more resources and we will work even more closely with the leading European NSS. Obtaining support from all constituents on the additional funding required, including potential EC funding, and on a structure for EFRAG under which it will be perceived by all involved parties to be independent, has been a long process. In addition, the NSS will be more closely involved under the amended structure and they will have a stronger influence on agenda setting for the proactive work, and on EFRAG's comments on the IASB agenda.

It is believed that the new structure will strengthen European input to the IASB and increase the profile of Europe in the worldwide architecture of IFRS standard-setting. We look forward to working even more closely with the NSS. We will live up to the agreement and we will use our best endeavours to ensure that all the players will benefit. EFRAG Plus enables EFRAG to increase its resources significantly and we have already stepped up our staff recruitment and as of 1st January 2009 we had more staff than ever before.

EFRAG Draft Comment letters

We have been led to believe that our draft comment letters are widely regarded by IFRS stakeholders not only in Europe but also around the world as helpful and important input in developing their comment letters to the IASB. It is a unique feature that ever since its formation in 2001, EFRAG has prepared draft comment letters and issued them for comment well before the IASB comment deadline. We understand they are very widely used despite the fact that they are published only on our website and are not promoted anywhere else. Our draft comment letters have always been very important to us, and we try to ensure that they explain our views clearly, even if this results in lengthy comment letters, in order to support our constituents. This is the reason why we have resisted the suggestions from some quarters that we shorten the letters. However, we might consider whether shorter final letters would be more influential with the IASB.

Françoise Flores
EFRAG TEG VICE-CHAIRWOMAN

It is important to us to maintain the high quality of our draft comment letters, and following the enhancement of EFRAG we will endeavour to monitor the work of the IASB more closely, so that we can comment at an even earlier stage on the work being carried out by the IASB. This is important, because many have the view that the IASB's thinking about the basis of new standards is generally at an advanced stage at the time an ED is issued and therefore we in Europe should endeavour to influence the IASB's thinking as early as possible as we have been trying to do through our pro-active activities.

EFRAG DRAFT COMMENT LETTERS ARE USED ALL OVER THE WORLD AS A BASIS FOR COMMENTING TO THE IASB

CONVERGENCE

We may have to accept certain features in new standards in order to get the US on board

Another step taken in 2008 was the agreement by the IASB and FASB to renew their MOU on their joint work programme. The new MOU includes a focus on agenda items linked to the possible US implementation of IFRS as well as common new standards. We support the latter, and we are pleased that they have given up the so-called short-term convergence projects that in our view were never a success. We are, however, concerned about the high emphasis that is being placed by the IASB on facilitating US adoption of IFRS because it might well delay or postpone important issues for those constituents - like us – that have implemented IFRS. We issued a letter to the IASB stating that a high priority should continue to be given to certain issues of critical importance to European constituents but today we should say subject to issues being urgent due to the financial crisis. However, we should to bear in mind the many changes that were introduced by the IASB to facilitate the EU adoption of IFRS and we should, therefore, recognise that we may have to accept certain features, such as more detailed standards and perhaps also more rules in the standards as the price of securing US adoption of IFRS. We need to consider where the limit is but we have to be flexible. However, such flexibility is only acceptable as long as the US really is committed to the adoption of IFRS.

During 2008, the IASB and FASB issued a similar standard on Business Combinations, a common ED on Consolidated Financial Statements and common DPs on Financial Statement Presentation and on Revenue Recognition. We support this direction provided that the IASB responds to the needs of its constituents who are applying IFRS such as Europe, and is not over-influenced by the US. It is relevant in this context that the enhancement of EFRAG will enable us in Europe to step up our dialogue with the IASB.

We believe that the IASB also needs to remind itself that there are other important constituents such as Japan. We should not forget China and India, but Japan has a fully developed set of standards, a strong standard setter, and a deep capital market.

INTERPRETATIONS

IFRIC has issued only a few Interpretations in the last year and we support that direction. Some of the draft interpretations and interpretations issued have, however, been somewhat controversial such as IFRIC 15 – Agreements for the Construction of Real Estate and IFRIC 17 – Distribution of Non-Cash Assets to Owners.
EFRAG issued strong comment letters to the IFRIC in response to the relevant EDs, as did others, and fortunately IFRIC improved the interpretations before they were issued.

WORKING WITH THE EUROPEAN COMMISSION (EC)

Endorsement advice and effect studies have taken a lot of resources during the year

In 2008 we worked even closer with the EC than in previous years, both in relation to endorsement and in relation to advice on technical consequences of activities to handle the crisis. For example, we co-chaired the stakeholder meeting organised by the EC in October, and we have evaluated various comments and proposals.

The working arrangement with the EC that was entered into in March 2006 - under which "EFRAG will provide advice to the Commission on all issues relation to the application of IFRS in the EU", in particular proactive input to the IASB and endorsement advice – has certainly proved to be worthwhile.

EFRAG has provided additional support to the EC in 2008 by working closely with it on effect studies in relation to final standards and interpretations issued by IASB. The effect study work was very demanding in 2008 because we had to carry out a more in-depth study on IFRIC 13 Customer Loyalty Programmes involving issuing and considering the responses based on direct interviews and detailed questionnaires to users and preparers. In addition we had to carry out an even more in-depth study on the amendments to IFRS 3 Business Combinations and IAS 27 Consolidations. This involved issuing long questionnaires and to carrying out extensive interviews with preparers to understand the effect of the new amendments. This work absorbed a major part of the resources in the secretariat for a period of time but we believe that we prepared a high quality study of which we can be proud. In our view such work should properly be carried out by the IASB before they issue new standards.

We are very grateful to the users and particularly the preparers who spent a considerable amount of time working with us on the effect studies.

ACCOUNTING REGULATORY COMMITTEE (ARC)

EFRAG attended the meetings of the ARC in 2008 as an observer, and we gave technical presentations when asked by the EC to do so. EFRAG appreciates the opportunity to work with the ARC and the representatives from the EU governments.

STANDARDS ADVICE REVIEW GROUP (SARG)

EFRAG met regularly with the SARG during 2008 and presented endorsement advices including our Basis for Conclusions. All the advices presented were evaluated by the SARG as objective and well balanced. We believe that the relationship with SARG is positive and productive and we appreciate the feedback and suggestions for process improvements made by the SARG.

ENDORSEMENT SITUATION

Europe has reduced the endorsement backlog during 2008 and the first months of 2009

A batch of IASB pronouncements were endorsed and published in the Official Journal on 18 and 19 December and on 22 and 24 January 2009. In addition ARC has voted on several pronouncements that as a result can be considered in the European Parliament and the EU Council. Finally IFRIC 12, Service Concessions Arrangements, issued by the IASB in 2006 was published as endorsed on 26th March 2009. The endorsement of IFRIC 12 was long overdue, so this decision was very welcome. The remaining backlog is all from 2008. It is expected that most of the old pipeline will be endorsed before the end of the European Parliament sessions in April 2009, but the standards and interpretations issued late in 2008 and early 2009 will not be endorsed until late in 2009.
Although there is a more positive attitude to speed up the endorsement process, it is nevertheless disappointing that it takes so long as this creates uncertainties for capital market participants.

A further concern about the endorsement process is that IFRIC interpretations in particular are frequently endorsed with a different effective date from that of the actual IASB pronouncement. The consequence is that the EU companies do not have the same starting date compared to each other but also compared to companies outside the EU. When this occurs, it effectively constitutes a temporary carve-out, which is regrettable. A particular case of this is IFRIC 12, which will not be mandatorily effective in the EU until 2010, whereas the effective date for IFRS purposes and therefore in countries outside Europe that use IFRS is 2008.

These problems with the endorsement process make it increasingly important for preparers to describe the framework they are complying with in order for the users to be able to fully understand the accounting. We believe that the financial statements should explain clearly when a company is complying with IFRS as adopted in the EU but not with IFRS as issued by the IASB.

The carve- out of parts of IAS 39 on financial instruments still exists and the parties need to find a solution

This, of course, brings us to issue of the carve outs in IAS 39, which consists of approximately 20 deletions from 13 paragraphs. The carve-outs were originally intended to be a temporary, short-term measure, to be used for two years, but they are now in their fifth year, and there has not been any real progress in getting them removed. We understand that only few banks use the carve-out option and while we accept that it

might be difficult to re-open discussions on the issue at this point in time, this is a pity because it weakens the position of Europe when discussing accounting and the direction of IFRS with the US and Japan and it weakens the credibility of European accounting generally. European constituents should seek to re-open a constructive dialogue on accounting for financial instruments with the IASB, and the IASB should try to listen carefully. The credibility of financial reporting by European banks needs to be improved following the financial crisis, and EFRAG will certainly do whatever we can to facilitate real and proper discussion, but we need both parties to be committed to making progress to the benefit of the capital markets and the economic recovery. The IASB'S decision to develop a new standard on accounting for financial instruments is welcome in this regard, although it remains to be seen whether the IASB is able to arrive at an approach that is acceptable to all parties.

THROUGH ITS HIGH LEVEL TECHNICAL EXPERTISE, EFRAG IS INCREASINGLY FULFILLING THE IMPORTANT ROLE OF PROVIDING UPSTREAM TECHNICAL ADVICE ON MANY DIFFERENT ISSUES UNDER IFRS.

Jeroen Hooijer
Head of Accounting Unit,
DG Internal Market
European Commission

OBJECTIVES OF FINANCIAL REPORTING BY BANKS

In recent years there has been pressure to bring together financial reporting by banks for capital markets and reporting for banking supervisory purposes into line with each other. It is certainly appropriate to avoid unnecessary differences between the two types of reporting but we have to keep in mind that the objectives of general purpose financial statements differ from the objectives of reports for supervisors. Whereas the role of supervisors is to protect banks' depositors, investors need financial statements in order to make decisions in their capacity as capital providers. The view has also been expressed that bank financial statements should be prepared on a basis that supports economic stability. We are concerned about overlaying such objectives on to financial reporting for capital markets purposes. Supervisors have powers to require additional information in order to protect depositors and society and they can impose and change capital requirements of banks in order to support stability.

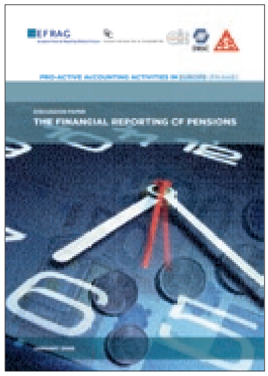
During the first months of 2009 and in the period leading up to the G-20 summit in early April it seems that the somewhat ill-defined concept of dynamic provisioning is being seen as the buzz word for solving the issue of loan loss provisioning. The term needs to be defined clearly in order to make it possible to assess how the concept relates to the IASB Framework and the wider implications of moving away from an incurred loss model.

USER PANEL AND USER INVOLVEMENT

EFRAG's User Panel was established in late 2006 and had four meetings in 2008. It has given EFRAG valuable input on the projects on our agenda, and it is also providing input on our effect study work, where user requirements and experience are especially important. The Panel's discussions have been very lively and the user representatives have given us a lot of new inspiration. We were fortunate in being able to increase the size of the Panel in 2008. We are looking for additional ways of increasing our contacts with users. In addition, we continue to seek additional members as user input is so important to us. Later in this Annual Review there is a specific report on the activities of the User Panel.

PROACTIVE ACCOUNTING ACTIVITIES IN EUROPE (PAAINE)

PAAinE is the partnership of the European national standard setters (NSS) and EFRAG that was initiated by EFRAG with the objective of improving the input



from Europe to the global standard setting process. The idea is to leverage the knowledge, understanding and limited resources available at EFRAG and at the European NSS in the most efficient way and a key objective is to stimulate, carry out and manage proactive development activities that will encourage debate in Europe on accounting issues and enhance the quality of proactive input to the IASB and possibly also the FASB. A Coordinators' Committee was set up to manage the activities.

In 2008 the following papers were issued:

- **The Financial Reporting of Pensions.** Project was led by the UK.
- **Distinguishing between Liabilities and Equity** Project was led by Germany.

In March 2009 we issued the **Performance Reporting: A European Discussion Paper**, and early in 2009 we issued summaries of comments on three discussion papers.

EFRAG TEG has discussed all the papers and has approved their issue with the EFRAG logo.

In addition, the coordinators agreed to go ahead with two new projects, namely

- **Accounting for entities under common control** led by Italy and EFRAG.
- **Accounting for Income Tax** jointly led by Germany and the UK.

Work has also been continued on specific parts of the Framework and is being led by France.

Reports from the various Advisory Groups set up to support the individual PAAinE projects are given later in this Annual Review.

Under the enhanced EFRAG arrangements the Coordinators will be replaced by the Planning and Resource Committee, but the group has agreed to continue as an advisory group to the PRC.

MEETINGS WITH CESR

We had several meetings with CESR-FIN representatives during the year and we increased the level of cooperation on accounting issues. The TEG chairman and the technical director have participated in meetings with CESR representatives and committees and we obtain input to our work from the participation of CESR representatives in TEG meetings.

MEETINGS WITH EUROPEAN NATIONAL STANDARD SETTERS

EFRAG invites all the European National Standard Setters to Brussels for a full day meeting every three months. We believe that it is important to maintain this forum to ensure that we continue to have direct contact and discussions with the NSS throughout Europe. Attendance at the meetings in 2008 was satisfactory. We seek to maximise the relevance of the meetings for NSS and received good feedback from a survey of NSS during the year.

MEETINGS AND VISITS

Visit to the US

The TEG chairman and the technical director supported by the chair of the German NSS visited the US in the spring of 2008 to meet with representatives of the FASB. We also visited the US Securities and Exchange Commission (SEC) and discussed with SEC staff the possibility of the US adopting IFRS and the consequences thereof.

Visit to Japan

In September 2008 the TEG chairman and the technical director visited Japan. It was an appropriate point in time to visit Tokyo because there was much interest in IFRS and IASB, and we benefitted from that. There was particular interest in how Europe had managed the transition to IFRS. We met with the Japanese SEC, the Japanese Accounting Standards Board, the Japanese Institute of Certified Public Accountants and constituents at a Round Table, and we gave presentations at Waseda University. Our host was the Japanese Accounting Standards Board and we met several times with representatives of the board and the staff.

WEBSITE

We are satisfied with the layout and the features of our website but we have experienced significant technical problems with the outsourced server and we therefore changed platform during 2008. The website is available for use by our constituents, but it also makes it vulnerable.

In general we have been satisfied with the website and the number of visitors.

We believe that our Endorsement Status Report, which is downloadable from our website, is widely used as the most up-to-date and easiest to access information on the subject.

EFRAG MOVED OFFICES

EFRAG moved offices at the end of 2008 and the new offices are situated at 35 Square de Meeûs. They give us more space, enabling us to house the increased staff and also give us a better meeting room. The offices are laid out in a light and bright style with strong colours at the entrance and other features. We believe they will serve us well, and they are enabling us to create a very good working atmosphere.

Paul Ebling
TECHNICAL DIRECTOR

TECHNICAL WORK

We thought 2007 was a busy year, but 2008 has been even more busy with some significant subjects on EFRAG's agenda, a plethora of Exposure Drafts, draft interpretations and Discussion Papers from the IASB and IFRIC for EFRAG to comment on and plenty of final standards, interpretations and amendments to assess for endorsement purposes.
The highest profile issues addressed in 2008 were probably the

- **Discussion Papers** on Financial Instruments with Characteristics of Equity, Reducing Complexity in Reporting Financial Instruments, the Framework chapter on the Reporting Entity, Insurance Contracts, and Financial Statement Presentation;
- **Exposure Drafts** on the Framework chapters on The objective of Financial Reporting and The Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information, Consolidated Financial Statements, and the proposed IFRS for SMEs; and
- **Endorsement Assessments** made of the revised IFRS 3 Business Combinations and IAS 27 Consolidated and Separate Financial Statements ('the Business Combinations 2 project').

Of course issues arising from the financial crisis were another major source of work during the year. All this work is discussed in more detail below.

On page 24 there is a list of all the letters issued by EFRAG in 2008.

GLOBAL FINANCIAL CRISIS

The crisis has coursed hectic activity for EFRAG in our work with the EC and responses to the IASB

This review of the technical work we have carried out in 2008 cannot really begin other than with an overview of our work related to the global financial crisis.

Back in April 2008 the Financial Stability Forum, a global organisation of regulators and central bankers, issued a report that analysed the causes of the market turmoil and the underlying weaknesses that made it possible, and made a series of recommendations on how to correct those weaknesses. The accounting and reporting matters the report highlighted were accounting for structured entities (ie derecognition, consolidation and disclosure), disclosure about risk and about fair value measures, and fair value measurement techniques.

The G7 Finance ministers and Central Bank Governors subsequently emphasised the need for the IASB to address these issues as a matter of urgency.

The EFRAG Chair issued a joint statement together with the Chairs of the French, German and UK standard-setters making it clear that they would support the IASB in its work and they accepted that comment periods on proposals emerging from this work would need to be shortened to enable appropriate changes to be made to standards and guidance to be issued quickly.

The IASB has subsequently issued material on all the areas mentioned by the Financial Stability Forum and EFRAG has done its best to respond quickly.

In the autumn there were strong calls within Europe for urgent changes to allow certain financial assets accounted for at fair value through profit or loss to be accounted for differently (either at fair value through equity or at amortised cost). In October the IASB issued an amendment to IAS 39 without following any due process; EFRAG moved quickly to issue its endorsement advice—also without due process—and within a few days the amendment was endorsed for use in the EU.

Also in October the **European Commission wrote to the IASB to ask it to urgently consider four other aspects of existing IFRS** that the Commission believed were causing unnecessary problems because of the crisis. The IASB almost immediately addressed one of those issues—the need for more guidance on estimating fair values when markets are disrupted—and also started actively looking at the other issues, which related to the fair value option, the treatment of certain embedded derivatives, and the impairment of available-for-sale securities. Following roundtables around the world it was agreed that the IASB should work jointly with FASB on these issues to ensure that a global solution was developed to what is a global problem. EFRAG participated in those roundtables and strongly supported the decision to seek global solutions.


EFRAG
European Financial Reporting Advisory Group

XX December 2008

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

DRAFT COMMENT LETTER

Comments should be sent to Commentletter@efrag.org by 1 December 2008

Dear Madam/Sir

Re: Exposure Draft Simplifying Earnings per Share

In December EFRAG invited officials from BAFIN, the German Federal Financial Supervisory Authority, to present the ideas it had developed on the valuation of financial instruments in inactive markets using discounted cash flow-models.

At the end of the year the IASB responded to calls for changes to the existing treatment of impairments of available-for-sale securities by issuing an ED proposing changes to the disclosures required about impairments (ED of proposed amendments to IFRS 7 Investments in Debt Instruments).

Although the ED had a very short comment period and most of that period was over the holiday season, EFRAG nevertheless managed to issue a draft letter on the ED for comment and to finalise its comment letter within the IASB's timetable. However, EFRAG—and most of the IASB's other constituents–did not support the proposals, and the IASB withdrew them in January 2009.

Around the same time concerns were increasingly being heard about the possibility that certain aspects of IFRS—the use of fair value measures for illiquid markets and the use of an incurred loan loss provisioning model—were having a pro-cyclical effect. The IASB and FASB concluded that all the concerns being raised were in fact symptoms of a wider problem and that what is needed is a slightly longer term project that looks properly at the underlying issues. EFRAG agrees with this strategy, as long as the solutions are forthcoming in months rather than years.

EFRAG expects to devote significant time over the next few months to commenting on the proposals that the IASB is developing on these subjects.

FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY

In EFRAG's view the IASB DP did not propose sound solutions, because the equity/liability distinction is a conceptual issue, and therefore needs to be addressed primarily at the conceptual level

Differentiating between equity and liabilities is fundamental to the existing accounting model because it determines not only the balance sheet totals but also those finance costs that are charged in arriving at profit or loss and those that are distributions of profit. The Framework defines equity as a residual; in other words, it is the amount of the interest in an entity's assets after deducting all its liabilities. However, this can result in some odd results and in recent years exceptions and complications have been introduced with the result that the principle has been largely replaced by rules. This is a problem, and the risk is that it will become even more of a problem if the US adopts IFRS because of some of the capital instruments that are widely used in the US. The IASB and FASB are therefore carrying out a joint project to develop a new, converged principle that can be used to determine how to classify financial instruments with characteristics of equity.

As part of this work, the IASB issued a FASB Preliminary Views document that considered three approaches to distinguishing equity from liabilities. In contrast to current IFRS literature, which defines an equity instrument as a financial instrument that is not a financial asset or a financial liability, all three approaches in the FASB document were based on a stand-alone definition of equity.

Although EFRAG agrees that it is necessary to improve the equity/liability distinction, we were not convinced that any of the proposed approaches were suitable replacements for the existing IFRS requirements in this area. We thought a major problem with the paper was that it started from the wrong place. In our view, if you wish to develop a clear principle to distinguish equity from liabilities, you have to start by asking what the purpose of distinguishing between equity and liabilities is—because, without articulating the purpose, it is difficult to identify criteria that can be used to assess whether one classification approach is better than another. We were also concerned that the paper seemed to have been developed independently of the work being carried out simultaneously in the Framework project on the definitions of assets, liabilities and equity. In our view, the issue the Discussion Paper is addressing is a conceptual issue, and therefore needs to be addressed primarily at the conceptual level. We also had a number of difficulties with each of the approaches discussed in the paper, and we argued that it was important that whichever approach is eventually chosen works for both separate financial statements and consolidated financial statements without the need for additional rules (which would inevitably be somewhat arbitrary).

The distinction between equity and liabilities is an important issue for Europe. It affects, for example, the many German entities whose share capital consists of puttable shares that are liabilities under the Framework definition. It also affects significantly Europe's many co-operative organisations. It is important that the solution eventually developed is able to cope with these and other types of instrument that are often seen in Europe. We will continue to monitor the IASB's work on the subject closely.

REDUCING COMPLEXITY IN REPORTING FINANCIAL INSTRUMENTS

It is premature – and perhaps even inappropriate - to conclude that the long-term measurement of financial instruments should be at fair value

It has been long been argued that IAS 39 Financial instruments: Recognition and Measurement is too complex and rule-based a standard and that what is needed is a standard that is simpler to understand and implement and more even-handed in its approach to similar positions. EFRAG shares this view and was therefore very enthusiastic when it heard that the IASB was developing a discussion paper entitled Reducing

Complexity in Reporting Financial Instruments.
To summarise, the paper identified two areas—measurement and hedge accounting—as the most significant causes of complexity, and it argued that one of the main ways to simplify the requirements would be to reduce the number of different ways of measuring financial instruments. From that it concluded that the long-term objective should be to measure all financial instruments in the same way—at fair value (so-called 'full fair value'). However, because there are a number of issues that need to be resolved before that would be possible, intermediate improvements need to be found. The paper discussed various possible intermediate approaches.

In our comment letter, EFRAG agreed with the IASB's view that measurement and hedge accounting were areas of IAS 39 that were the cause of much complexity and should therefore be the initial focus of the project. However, we thought it was premature, and perhaps even inappropriate, to conclude that the long-term objective should be full fair value. In EFRAG's view the reality is that we will have a mixed measurement model for the foreseeable future and the focus of everyone's efforts should be to find ways of improving and simplifying that mixed measurement model.

EFRAG argued that the existing classification system—held-for-trading, available for sale, loans and receivables, held-to-maturity, etc—was the source of many of the problems and that, rather than simply looking to eliminate one of the categories, the IASB should take a fresh look at the system and see if it could develop a more factually-based approach to classification that would make it unnecessary to have debates about choice and reclassifications, result in like items being treated alike and make unnecessary complex rules to police the boundaries between categories.

EFRAG also argued that, rather than allowing anomalies in the hedge accounting rules to remain due to the fact that hedge accounting is itself some sort of exception, the IASB should develop a principle-based hedge accounting model that would better reflect sound risk management practices and their impact on the economic performance of the entity. "Such a model", EFRAG stated in its letter, "should, inter alia, provide a principle-based hedge accounting solution for portfolios of financial instruments used to hedge net exposures on other portfolios of financial instruments."

EFRAG also expressed the view that it is essential that the long-awaited comprehensive debate about measurement takes place as soon as possible so that consensus can be reached on issues such as how many different measurement bases are appropriate for use in financial statements and the circumstances in which each basis should be used.

This is now a high-priority project for the IASB, and EFRAG is following the IASB's work closely.

FRAMEWORK

IASB intends to issue the first two chapters of the new framework without waiting for the other parts to be finished. As a result, the Framework will be a mixture of old and new. It will therefore be internally inconsistent. In EFRAG's view such an approach is not appropriate

During the year the IASB issued an Exposure Draft of the first two chapters of a new, converged Framework—on objectives and qualitative characteristics—and also a Discussion Paper on the reporting entity notion.

Focusing first on the ED, EFRAG generally thought it was a significant improvement on the version of the chapters that was set out in an earlier discussion paper, and it was particularly pleasing to see the improved treatment of the notion of stewardship in relation to the objectives of financial reporting. EFRAG raised various concerns in its comment letter, and probably the two biggest were:

- the fact that the IASB was proposing to finalise and issue these two chapters without waiting for the other parts of the Framework to be finalised. Such an approach will lead to a Framework that is not internally consistent and, bearing in mind the role the Framework plays in the hierarchy, such inconsisten-

cy seems undesirable.
- the proposal that an entity perspective should be used to prepare the financial statements. EFRAG believes strongly that a comprehensive and in-depth debate is needed on the perspective from which financial statements should be prepared before any conclusions are reached but such a debate has not yet taken place. EFRAG thought it was particularly disappointing that the material in the ED was not sufficient to enable such a debate to take place.

The Reporting Entity Discussion Paper raised a number of issues that have been explored further—with some differences in the conclusions reached—in the IASB's recent ED 10 Consolidated Financial Statements. The Discussion Paper raised a number of important but too rarely discussed issues. EFRAG agreed with many of the paper's conclusions but did not agree:

- with the proposal that control on its own should be used as the basis for determining the composition of a group reporting entity. EFRAG argued that the high-level consolidation principle should involve both control and risks and rewards; or
- with the proposal that the consolidated financial statements should be presented from an entity perspective.

The Discussion Paper also contains a lengthy discussion of the role played by the single entity financial statements of a parent entity. EFRAG agreed that, if an entity that is a parent prepares a set of primary financial statements and accompanying notes that contain no information prepared on a consolidated basis, those financial statements will often not meet the objective for general purpose financial reporting and will often need to be supplemented by a full set of consolidated financial statements to enable the objective to be met. On the other hand, EFRAG also thought that financial statements and notes containing only information prepared on a consolidated basis would often not be sufficient to meet the objective; at least some parent-only information needs to be provided to enable the objective to be met.

INSURANCE CONTRACTS

This is a very important project, and a standard is urgently needed; but there is a long way to go to develop a satisfactory set of proposals

EFRAG's position for some time now has been that a comprehensive standard on accounting for insurance contracts is urgently needed, in Europe at least. As the IASB had been working on the subject for many years, we were delighted to see it issuing a major discussion paper on the subject in late 2007. Indeed, although we had some major issues with what the paper said in places, we nevertheless congratulated the IASB for taking on the leadership of the project, for committing so much time and energy to it, and for developing and issuing a paper which we believe makes a significant contribution to the debate and represents an excellent basis on which to debate the accounting treatment of insurance contracts.

EFRAG's comment letter on the discussion paper was prepared with the help of EFRAG's Insurance Accounting Working Group, which provided EFRAG with valuable technical expertise and other input, and after taking into account the many insightful comments we received from constituents in response to our draft letter. The letter makes it clear that the main difficulty EFRAG had with the paper was that many of the issues it discussed—including fundamental issues like revenue recognition and measurement of liabilities—are not insurance-specific issues. As a result, EFRAG found it necessary to try to assess whether the principles proposed in the paper could be applied generally and, if the conclusion was that they could not, why that was - were the principles wrong or were there differences between insurance and other types of transaction that justified different treatments? This was not an easy assessment to make and it meant that EFRAG was unable to reach conclusions on a number of important proposals. For example, whilst EFRAG agreed that an insurance liability should be measured at an amount that comprises the expected present value of the future cash flows plus some sort of margin, it did not find the discussion in the paper helpful in reaching conclusions as to what that margin should represent. And that made it difficult to reach conclusions on whether the measurement basis should be an entry value or an exit value, or whether it should be an in-use value or a market-based value. These issues are, of course, fundamental to the debate.


EFRAG

Jörgen Holmquist
Director General
European Commission
Directorate General for the Internal Market
1049 Brussels

7 November 2008

Dear Mr Holmquist

Adoption of IFRS 3 (Revised) Business Combinations

FINANCIAL STATEMENT PRESENTATION

The proposals will fundamentally change the presentation of financial statements, and the DP has many interesting ideas. However, these ideas need to be improved

2008 started with EFRAG developing endorsement advice on the relatively minor changes made to existing IFRS by revised IAS 1 Presentation of Financial Statements—which represented Phase A of the IASB's Financial Statement Presentation project—and ended with EFRAG developing its comment letter on the Phase B Discussion Paper issued by the IASB in October 2008. The proposals in this paper would, if implemented, significantly change the way the primary financial statements look, with considerable re-ordering and re-structuring, additional sub-totals and, we think, much more detail on the face of the financial statements. There would also be a major new disclosure item, namely a reconciliation between the cash flow statement and the statement of income and expense.

At the time of writing we have issued our draft comment letter and are awaiting responses to that draft before finalising the letter. We have already discussed the letter with a wide range of constituents, including European national standard-setters, EFRAG's User Panel, banks, insurers, and others. Our draft letter supports the presentation principles proposed in the paper (including cohesiveness), but criticises the way the paper seems to envisage them being applied in practice. We think a less mechanical, more thoughtful application is needed if the resulting information is to represent a significant improvement on the existing position. We also have concerns about the proposed new reconciliation schedule; we suspect it will require the disclosure of many numbers, only a few of which are likely to prove useful. And we are not persuaded by the paper's arguments that the direct method of presenting the statement of cash flows should be prescribed.

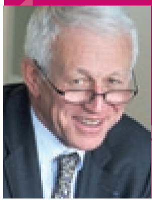
IFRS FOR SMEs

Full IFRS is not suitable for small and medium-sized entities. The IASB's proposals were a step in the right direction, but do not go far enough

The IASB issued its exposure draft of a proposed IFRS for Small and Medium-sized Entities (SMEs) in 2007, and EFRAG issued its comment letter on the ED in February 2008. In that letter, we explained that we are of the view that full IFRS is too complex to serve the needs of users of financial statements of entities without public accountability. That is not necessarily a criticism of full IFRS, it is just that full IFRS focuses primarily on serving the needs of capital markets, and those needs are not those of users of financial statements of entities with no public accountability. It does mean, however, that it is very important that the simplified set of standards for entities that do not have public accountability are developed on the basis of a good understanding of the information needs of users of such entities' financial statements. Information that might be extremely useful for capital market participants may be less useful for users of non-publicly accountable entities, and the costs of preparing the information might be significantly different too. The need to balance costs and benefits could mean, therefore, that what is an appropriate requirement for a publicly accountable entity is not an appropriate requirement for a non-publicly accountable entity. Developing the IFRS for SMEs is therefore not simply about the 'right' or 'wrong' accounting.

EFRAG argued in its letter on the ED that the IASB has made good progress towards these objectives. For example, we thought the IASB was right to conclude that the standards should be a stand-alone document and that recognition and measurement simplifications are needed. The decision to separate the ongoing maintenance of the standards from the revision process for full IFRS was also a good one.

EFRAG HAS QUICKLY BECOME AN IMPORTANT PLAYER ON INTERNATIONAL ACCOUNTING. EFRAG PROVIDES SOLID EUROPEAN VIEWS EARLY IN THE STANDARD-SETTING PROCESS.



Philippe Danjou
IASB member

However, EFRAG also argued that the proposed standard can be—and needs to be—further improved. For example, we thought that:

- further changes are needed to make the standard a truly stand-alone document. We also thought the proposed standard needed to be made easier to use;
- there needs to be a more thorough analysis of users' information needs and the proposals need to more effectively reflect those needs; and
- in any event, further recognition and measurement simplifications are both necessary and possible.

The IASB spent the rest of 2008 re-deliberating its proposals in the light of the comments received, with a view to issuing the final standard in mid-2009. We have continued to monitor those discussions and, partly because we were concerned that the IASB might not have taken on board the messages in our comment letter on the ED, we wrote to the IASB again in October 2008. In that letter we commended the IASB for its tentative decisions to make the standard a truly stand-alone document and to clarify the standard's scope by changing the standard's name. We also said that the IASB's efforts to simplify the form of the standard and increase its understandability and to reduce disclosures were much appreciated and represented an important step in the right direction. However, we also encouraged the IASB to re-consider some of its tentative decisions in order to achieve some further, much-needed significant simplifications in the recognition and measurement requirements.

In the October 2008 letter, EFRAG also noted that the GASB, the German Standard Setter, had led a survey of banks as users of private entity financial statements. As banks are acknowledged to be one of the main users of general purpose financial statements issued by private entities, this survey is particularly relevant to the debate over the IFRS for SMEs. We pointed out that the GASB survey confirmed many of our own perceptions, and went on to reiterate some key messages from our comment letter that seem to us to flow from those perceptions.

BUSINESS COMBINATIONS AND CONSOLIDATION

The amendments were given positive endorsement advice

The two, long-awaited—and rather controversial—standards on phase 2 of the Business Combinations project (the Revised IFRS 3 Business Combinations and IAS 27 Consolidated and Separate Financial Statements) were issued in January 2008 by the IASB. EFRAG spent much of the first half of 2008 assessing the standards for the purposes of EFRAG's endorsement advice and effects study reports. Our discussions were long, with strong views being expressed both in support of and against the various individual amendments. EFRAG also consulted widely on the likely effects of the standards, using long questionnaires to preparers and to users together with in-depth interviews with preparers to understand the effects of the amended standards. Overall it seemed that many of our constituents were not as concerned about the standards as were some EFRAG members. Eventually, we concluded that the costs of implementing the standards were likely to be exceeded by the benefits and that the standards met the endorsement criteria generally, and accordingly we issued positive endorsement advice letters on both standards in November 2008.

EFRAG PUBLICATIONS AND ACTIVITIES IN 2008

EFRAG Letters 2008	Draft Comment Letter	Final Comment Letter	Draft Endorsement Advice*	Final Endorsement Advice*
IFRSs				
Amendment to IAS 39 Financial Instruments - Recognition and Measurement Exposure Qualifying for Hedge Accounting	28-11-2007	**15-02**	**22-09**	**12-11**
Amendment to IFRS 2 Share-Based Payment - Vesting Conditions and Cancellations	28-2-2006	1-6-2006	**13-3**	**12-05**
Amendment to IFRS 5 – Discontinued Operations	**17-12**	30-1-2009		
Amendments to IAS 1 – Revised Presentation of Financial Statements	21-4-2006	24-7-2006	14-9-2007	**17-4**
Amendments to IAS 24 – Relationships with the State	**22-12**	1-4-2009		
Amendments to IAS 32 and IAS 1 - Puttable Financial Instruments and Obligations Arising on Liquidation	1-10-2006	23-10-2006	**26-03**	**16-05**
Amendments to IAS 33 – Simplifying Earnings per Share	**20-10**	**22-12**		
Amendments to IAS 39 – Eligible Hedged Items	28-11-2007	**15-02**	**22-10**	**12-11**
Amendments to IAS 39 Financial Instruments - Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures “Reclassification of Financial Assets				**14-10**
Amendments to IFRS 1 – Additional Exemptions for First-time Adopters	**24-11**	28-1-2009		
Amendments to IFRS 1 and IAS 27 - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate	**15-01**	**27-03**	**30-05**	**21-07**
Amendments to IFRS 2 and IFRIC 11- Group Cash-Settled Share-Based Payment Transactions	**06-02**	**11-04**		
Amendments to IFRS 7 – Improving Disclosures About Financial Instruments	**04-11**	**15-12**	3-4-2009	
Improvements to IFRSs (2007)	29-10-2007	**29-01**	**22-05**	**04-07**
Improvements to IFRSs (2008)	**20-10**	**15-12**		
Revised IFRS 3 Business Combinations and IAS 27 Consolidated and Separate Financial Statements	12-05-2005	28-11-2005	**30-07**	**07-11**
Update to the Amendments to IAS 39 and IFRS 7 – Financial Instruments: Disclosures ‘Reclassification of Financial Assets’			**08-12**	15-1-2009
IFRIC				
IFRIC 13 – Customer Loyalty Programmes	27-9-2006	28-11-2006	07-9-2007	**13-03**
IFRIC 14 – IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their interaction	24-10-2006	24-11-2006	25-7-2007	**17-04**
IFRIC 15 – Real Estate Sales	18-9-2007	7-12-2007	**29-07**	**03-11**
IFRIC 16 – Hedges Of a Net Investment in a Foreign Operation	19-9-2007	26-11-2007	**18-9**	**03-11**
IFRIC 17 – Distribution of Non-Cash Assets to Owners	**08-04**	**06-06**	14-3-2009	
IFRIC 18 – Transfers of Assets from Customers	**12-03**	**09-05**	26-3-2009	

*A separate effects study report was issued for some of the projects.

EFRAG Letters 2008	Draft Comment Letter	Final Comment Letter	Draft Endorsement Advice	Final Endorsement Advice
Other Letters				
An Improved Conceptual Framework for Financial Reporting – Chapter 1 The objective of Financial Reporting, and Chapter 2 Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information	**28-07**	**21-10**		
Discussion Paper Preliminary Views on Amendments to IAS 19 Employee Benefits	**29-07**	**17-10**		
Discussion Paper Preliminary Views on an Improved Conceptual Framework for Financial Reporting: The Reporting Entity	**30-7**	**22-10**		
Discussion Paper: Financial Instruments with Characteristics of Equity	**27-06**	**19-9**		
Discussion Paper: Insurance Contracts	3-10-2007	**22-02**		
Discussion Paper: Reducing Complexity in Reporting Financial Instruments	**23-07**	**30-09**		
IASB discussions about its agenda and priorities	**12-06**	**22-07**		
IFRS for Non Public Accountable Entities	19-4-2007	**07-02**		
Joint Arrangements	7-12-2007	**06-02**		
Other Publications				
Letter to the IASB on IFRS for Non Public Accountable Entities		**28-10**		
PAAinE Discussion Paper: Distinguishing between Liabilities and Equity	**28-01**			
PAAinE Discussion Paper: The Financial Reporting of Pensions	**30-01**			
Publications of EFRAG's Supervisory Board				
EFRAG enhancement public consultation	**23-07**	**10-12**		
IASCF Review of the Constitution		**06-10**		

Letters issued in 2008 in total	
Draft Comment Letters	16
Final Comment Letters	19
Draft Endorsement Letters	10
Final Endorsement Letters	13
Other Publications - Discussion Papers	6
TOTAL	**64**

Activities		
Technical Meetings	TEG (3 days)	10
	TEG conference calls	21
	CFSS	4
	Working Group Meeting	8
	User Panel	4
	Others	31
Speeches	Chairman TEG	25

FINANCIAL HIGHLIGHTS

EUROPEAN FINANCIAL REPORTING ADVISORY GROUP (EFRAG)

Abbreviated Financial Statements as of 31 December 2008

Income Statement	2008 '000 €	2007 '000 €
Members' Contribution	1082	1338
National Funding Mechanisms	593	283
Total Contributions	**1675**	**1621**
Personnel costs	-1042	-997
Office costs	-221	-130
Meeting costs	-27	-26
Other costs	-121	-122
Operating Expenses	**-1411**	**-1275**
Operating Profit or Loss	**264**	**346**
Financial Result	**29**	**1**
Net Profit or Loss	**293**	**347**

Balance Sheet	31 December 2008 '000 EUR	31 December 2007 '000 EUR
Total Fixed Assets	241	52
Total Current Assets	1437	1193
Total Assets	**1678**	**1245**
Accumulated surplus	1365	1060
Creditors	325	185
Total Liabilities	**1678**	**1245**

The financial highlights are based on statutory financial statements audited by BDO, Belgium.

In 2008 the expenses increased by 11% even though we had again expected to employ more staff. EFRAG received contributions from National Funding Mechanism larger than last year's voluntary contributions.

RELATIONS WITH STANDARD-SETTERS

European National standard-setters

EFRAG meets quarterly with European national accounting standard setters in its *Consultative Forum of Standard Setters.*

During these meetings EFRAG discusses current European accounting issues and major proposed changes to IFRSs with national standard-setters in the presence of IASB members. These discussions allow EFRAG to have a better understanding of the impact of proposed amendments on national accounting standards and business practice. In 2008 the CFSS met four times.

The meetings are making it possible to share knowledge between the organisations, to have access to up to date information in a co-ordinated way, and most importantly, to ensure that the views expressed in Europe are heard and understood by the IASB/IFRIC and have influence.

Together with some European standard-setters EFRAG is carrying out pro-active activities on accounting as part of its so called PAAinE activities (see page 33). This initiative is intended to stimulate debate on important items on the IASB agenda at an early stage in the standard-setting process before the IASB formally issues its proposals. It has the joint ambition of representing a European point of view and of creating or enhancing debate in Europe. Eight papers have been issued as part of these activities and are free for download on our website. Two projects were finalised in 2008: Financial Reporting of Pensions and Distinguishing between Equities and Liabilities. Four projects are in progress: on the Conceptual Framework, Common Control Transactions, Accounting for Income Tax and Performance Reporting.

European national standard-setters are also important partners as commentators on our draft comment letters and draft endorsement advice letters.

Relations with global standard-setters

EFRAG also participates in the global standard-setters meetings which are chaired by Ian Mackintosh (UK ASB). In 2008 the meetings took place in Melbourne (Australia) and London (United Kingdom). EFRAG also participates in the world standard-setters annual meeting organised by the IASB. The meeting took place in London.

FROM THE VIEWPOINT OF A SMALL STANDARD-SETTER EFRAG IS DOING EXACTLY WHAT IS IMPORTANT TO US RESULTING FROM THE FACT THAT WE HAVE EXTREMELY LIMITED RESOURCES AT NATIONAL LEVEL TO PRODUCE AS HIGH QUALITY RESPONSES TO THE IASB AS DOES EFRAG.

A national standard-setter in EFRAG's survey about CFSS meetings.

USER PANEL

The EFRAG User Panel was established in late 2006, and has met on quarterly basis since then. The Panel was comprised initially of fourteen members mostly all users of financial statements and grew to fifteen members by the end of December 2008; this despite the resignation of a number of Panel members in 2008 due to the financial crisis and the demands placed on analysts during that period. Membership of the User Panel remained focused on building up a group of users of financial statements with a wide range of experience in different user sectors within Europe, including equity analysts, financial analysts and financial consultants (see page 29). Stig Enevoldsen, EFRAG TEG Chairman, continues to chair also the User Panel.

The key purpose of the User Panel remains assisting EFRAG in its work by providing input from the user community to EFRAG's comment letters to the IASB, the endorsement advice and effect study report it provides to the European Commission. Consistent with the Panel's objective, special attention is given to accounting issues that require EFRAG to obtain a thorough understanding of user needs, thereby assisting EFRAG in developing its views on endorsement of the Standard or Interpretation being considered. The Panel also contributes input to the long-term proactive work being carried out by EFRAG and the European standard setters. In 2008, the Panel met three times for one day in Brussels and held one half-day meeting via conference call. The topics selected for each of the meetings depended primarily on the key accounting matters that EFRAG was addressing at the time, and the urgency of the various issues that arose during 2008, especially during the third quarter of 2008 as the financial crisis hit its worse peak of that year.

During the first half of the year, the Panel was asked for their views on a number of effect study reports prepared by EFRAG, including the report on the impacts of the new standards on the accounting for Business Combinations. This was an important piece of work that EFRAG had carried out and views of the user community played a key role in EFRAG's findings tabled in this report. During the second half of 2008, the Panel discussed the then forthcoming Discussion Paper on Financial Statement Presentation and the expected changes to Earnings per Share.

The Panel meeting in December 2008 focused largely on topics surrounding the financial crisis, including the Amendment made to IAS 39 Financial Instruments: Recognition and Measurement regarding the reclassification of financial assets and also the IASB's project on Consolidation. During this meeting the Panel also discussed IFRIC 17 addressing Distribution of Non-cash Assets and the changes being proposed by the IASB on IFRS 5 discontinued Operations. The Panel also commenced the discussion on the IASB's long-awaited Discussion Paper on Revenue Recognition.
Given the many significant accounting events and publications on IFRS issued in 2008, the input obtained from the Panel during the year has been a very valuable contribution to EFRAG in its due process and our fundamental role in advising the European Commission on accounting matters.

BY ESTABLISHING A USER PANEL, EFRAG HAS ENSURED THAT USERS OF FINANCIAL STATEMENTS, WHO OTHERWISE DO NOT HAVE A PAN-EUROPEAN FORUM TO EXPRESS VIEWS WITHIN THE EUROPEAN STANDARD ENDORSEMENT PROCESS, ARE HEARD ON A FORMAL AND REGULAR BASIS. THIS IS CRITICAL IF WE ARE TO HAVE HIGH QUALITY ACCOUNTING STANDARDS THAT MEET THE NEEDS OF USERS, PASSED INTO LAW.

Jed Wrigley
EFRAG User Panel member

MEMBERS OF THE USER PANEL

- **Stig Enevoldsen** - User Panel Chairman - TEG Chairman;
- **Jean-Baptiste Bellon** - Financial Analyst (Trapeza Conseil);
- **Javier de Frutos** - CEO (Grupo BBVA);
- **Jacques de Greling** - Equity Analyst (CDC IXIS Securities);
- **Sergio Lamonica** – Managing Director (LECG Consulting Italy);
- **Michael Schickling** - Director (Brunswick Group);
- **Friedrich Spandl** - Director (BAWAG);
- **Alison Thomas** - Director (PWC);
- **Guy Weyns** - Managing Director Global Valuation & Accounting (Morgan Stanley);
- **Jed Wrigley** - Fund Manager, Director of Accounting & Valuation (Fidelity International);
- **Carsten Zielke** - TEG Member.

In addition, the EU Commission and TEG members are given observer seats.

The following members joined the Panel during the course of 2008:

- **Roar Hoff** – Financial Analyst (Norske Finansanalytikers Forening);
- **Sue Harding** – Credit Analyst (Standard and Poors);
- **Thomas Justinussen** – Financial Analyst (Danske Bank);
- **Thomas Kaiser** – Head of Accounting and Valuation (Landesbank Baden-Württenberg).

REPORT FROM THE EFRAG WORKING GROUPS

FINANCIAL INSTRUMENTS

As previously mentioned, due to the global financial crisis financial instruments reporting was under the spotlight in 2008. There were calls for reviews of the existing standards on accounting for securitisations and other structured off-balance sheet financing entities, on impairment, on the measurement of financial instruments at fair value in illiquid markets and on fair value measurement generally, and on disclosures about risk and measurement uncertainty. The IASB came forward with a number of responses to these calls, designed to achieve lasting improvements in financial reporting, and EFRAG sought to respond in a timely manner to the IASB's proposals.

The IASB also issued for comment, at the beginning of 2008, the Discussion Papers Reducing Complexity in Reporting Financial Instruments and Financial Instruments with Characteristics of Equity. EFRAG's Financial Instruments Working Group discussed these proposals on several occasions during the year and provided input to EFRAG TEG to enable it to respond to the Discussion Papers in a well informed and a timely manner. The Group also discussed the IASB's work on the derecognition of financial assets, which is expected to result in an exposure draft in Q2 2009. The Group also provided input on a number of other financial instrument- and/or financial crisis-related issues during the year. Bearing in mind that 2008 has been such a very busy year for professionals involved in financial instruments-related matters, EFRAG is especially grateful to all members of the Group for their contribution to EFRAG's activities during these troubled times.

2009 promises to be an even busier year, with major new exposure drafts expected on derecognition, fair value measurement, financial instruments with characteristics of equity, and a replacement for IAS 39, as well as a number of narrower—but no less important—proposals for change.

2008 is the fourth year since the Group was established. At the end of the year, EFRAG's Supervisory Board decided to refresh and re-balance the Group's membership and therefore made a public call for applications for membership of a re-constituted Group. The new membership was announced early in 2009. EFRAG is pleased that a number of members from the previous Group will continue as members of the new Group and, together with the new members, will continue to contribute to EFRAG's work on financial instruments-related issues on behalf of its European stakeholders.

INSURANCE ACCOUNTING

2008 started where 2007 left off, with EFRAG's Insurance Accounting Working Group helping EFRAG to finalise its comment letter on the IASB's Discussion Paper Insurance Contracts. For some time now EFRAG has been emphasising that it is essential for Europe to have a comprehensive insurance standard in place as soon as possible and, bearing that in mind, it was very important that EFRAG commented effectively and thoroughly on the IASB's Discussion Paper, and the advice and input of EFRAG's Insurance Accounting Working Group made that possible.

In the spring the Group discussed a number of non-insurance projects that are potentially very significant to the industry, including the IASB's work on revenue recognition, financial statement presentation, financial instruments and equity/liability, as well as the PAAinE work on pensions. The Group will continue to take a close interest in these projects because it is recognised that the approach the IASB eventually decides to take in its insurance project is likely to be heavily influenced by its views on the cross-cutting issues being addressed in such projects. For example, one of the main issues discussed in the Insurance Contracts

Discussion Paper is also the key issue underlying the revenue recognition project; when an entity enters into a contract with a customer and the customer pays the consideration due under the contract, what is the entity's liability and how (and when) does that liability change as contract performance progresses? EFRAG is generally in favour of the IASB developing principles that can be applied to all types of entity, so it is important to consider such issues from the perspective of a wide variety of industries.

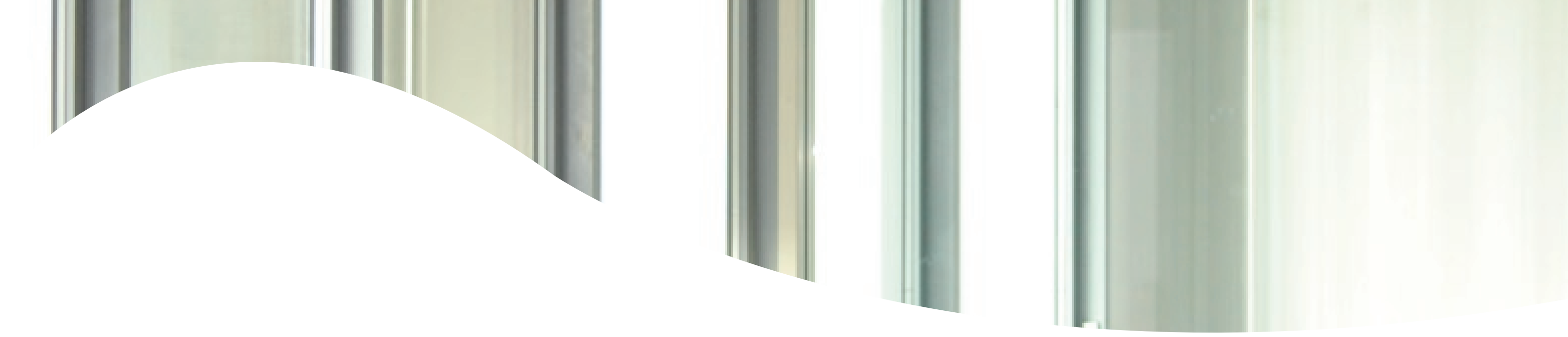
As with the Financial Instruments Working Group, it is now four years since the Group's membership was last re-balanced, so in the Autumn EFRAG's Supervisory Board invited applications for a re-constituted Group. The new membership was announced in November 2008, and the newly constituted Group met for the first time in January 2009. EFRAG would like to put on record its gratitude for and appreciation of the hard work and dedication of those members who stepped down as a result of these changes, and its thanks for those who offered themselves for membership of the new Group.

The IASB's technical plan envisages the IASB issuing an Exposure Draft of a proposed standard on Insurance Contracts before the end of 2009. Bearing this in mind, it is expected that the new Group will meet frequently during the year to discuss the IASB's thinking as it involves, and in due course to start working with EFRAG TEG on developing views for inclusion in an EFRAG comment letter on the ED.

IFRS FOR SMES

The IASB issued its exposure draft of a proposed IFRS for Small and Medium-sized Entities (SMEs) in 2007, and EFRAG issued its comment letter on the ED in February 2008. In that letter, we explained that we are of the view that full IFRS is too complex to serve the needs of users of financial statements of entities without public accountability. That is not necessarily a criticism of full IFRS, it is just that it focuses primarily on serving the needs of capital markets, and those needs are not those of users of financial statements of entities with no public accountability. It does mean however that it is very important that the simplified set of standards for entities that do not have public accountability are developed on the basis of a good understanding of the information needs of users of such entities' financial statements. Information that might be extremely useful for capital market participants may be less useful for users of non-publicly accountable entities, and the costs of preparing the information might be significantly different too. The need to balance costs and benefits could therefore mean that what is an appropriate requirement for a publicly accountable entity is not an appropriate requirement for a non-publicly accountable entity. Developing the IFRS for SMEs is therefore not simply about the 'right' or 'wrong' accounting.

EFRAG argued in its letter on the ED that the IASB has made good progress towards these objectives. For example, we thought the IASB was right to conclude that the standards should be a stand-alone document and that recognition and measurement simplifications are needed. The decision to separate the ongoing maintenance of the standards from the revision process for full IFRS was also a good one. However EFRAG also argued that the proposed standard can be - and needs to be - further improved.



For example, we thought that:

- further changes are needed to make the standard a truly stand-alone document. We also thought the proposed standard needed to be made easier to use;
- there needs to be a more thorough analysis of users' information needs and the proposals need to more effectively reflect those needs; and
- in any event, further recognition and measurement simplifications are both necessary and possible.

The IASB has spent the rest of the year re-deliberating its proposals in the light of the comments received, with a view to issuing the final standard in mid-2009. We have continued to monitor those discussions and, partly because we were concerned that the IASB might not have taken on board the messages in our comment letter on the ED, we wrote to the IASB again in October 2008. In that letter we commended the IASB for its tentative decisions to make the standard a truly stand-alone document and to clarify the standard's scope by changing the standard's name. We also said that the IASB's efforts to simplify the form of the standard and increase its understandability and to reduce disclosures were much appreciated and represented an important step in the right direction. However, we also encouraged the IASB to re-consider some of its tentative decisions in order to achieve some further, much-needed significant simplifications in the recognition and measurement requirements.

In October 2008, the joint EFRAG/FEE SMEs Working Group met and discussed the IASB's re-deliberations of the ED's proposals in the light of the comments received, what use might be made in Europe of the final IFRS for SMEs, and a survey of banks as users of private entity financial statements that had been carried out by the German national standard-setter. In its October 2008 letter, EFRAG drew the IASB's attention to the survey and pointed out that, as banks are acknowledged as one of the main users—perhaps the main user—of general purpose financial statements issued by private entities, this survey is particularly relevant to the debate over the IFRS for SMEs. We also pointed out that the GASB survey confirmed many of our own perceptions, and went on to reiterate some key messages from our comment letter that seem to us to be a consequence of those perceptions

REPORT FROM THE PAAINE ADVISORY GROUPS

CONCEPTUAL FRAMEWORK

The PAAinE pan-European Advisory Group on the Conceptual Framework was set up in 2006 to provide advice and other input to the staff team leading the PAAinE project on the Conceptual Framework. The objective of the PAAinE project, which is led jointly by staff of the French national standard-setter and of EFRAG, is to ensure that Europe participates actively, effectively and at an early stage in the joint IASB and FASB project on the Framework.

The project's first output took the form of a discussion paper *(Elements of the Framework Debate: The Conceptual Framework—Starting from the right place?)* that was issued in late 2006. A second paper *(Stewardship/Accountability as an objective of Financial Reporting)* was issued in June 2007. In 2008 the project—and the work of the Group—focused on two other pieces of work.

The first piece of work is a survey of the information needs of users. The principal aim of the survey is to determine how useful different forms of financial information are to users in their decision-making process, what improvements to financial information users require, and whether certain assumptions made by the IASB about the cash flow predictive objective of financial reporting and the stewardship objective of financial reporting are valid. 32 user organisations from 10 countries took part in the survey. An analysis of the survey results seem to suggest that financial statements and management commentary are the most useful forms of financial information. They also results seem to indicate that users believe the main improvements required to the financial statements are improved comparability—a key aspect of which is greater stability of reporting standards—simpler presentation formats, more or better quality prospective information and improved disclosures about risk and about underlying trends in growth and profitability. A full report of the survey results is expected to be issued in Q2 2009.

The PAAinE project has also been focusing on the new definition of an asset that the IASB has been developing. The current definition is that an asset "is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity." The new definition the IASB has developed is that an asset "is a present economic resource to which the entity has a right or other access that others do not have." In other words, the main proposals are to replace the notion of 'control' with 'right or other access', and to remove the reference to there being an expectation that future economic benefits will flow to the entity from the resource. The objective of the PAAinE work is to test the proposed new definition, and indeed the existing definition, against a series of transactions to identify and analyse the likely differences in practice between the definitions. The conclusions of this work will be used as part of Europe's input to the IASB's deliberations. It is expected that a report based on this work could be issued as early as Summer 2009.

DISTINGUISHING BETWEEN LIABILITIES AND EQUITY

As has already been mentioned, differentiating between equity and liabilities is fundamental to the existing accounting model. It is also the subject of a joint IASB/FASB project. In February 2008 the IASB issued a Discussion Paper on the subject Financial Instruments with Characteristics of Equity. That Discussion paper comprised an IASB-prepared invitation to comment on a FASB-prepared Preliminary Views document.

Partly in response to the approach that the FASB project was originally taking, a PAAinE project on the subject was started under the leadership of the German standard-setter. A pan-European Advisory Group was set up to provide advice and input to the project leader. One of the key objectives of this PAAinE work was to help ensure that any new equity/liability model should work well for all types of corporate structure and capital instrument, including those that are common in Europe but perhaps less common in other parts of the world.

The PAAinE work started by analysing why it was considered necessary to distinguish between equity and liabilities, and it used those reasons as the basis for developing a distinction between the two types of capital. In particular, the project took as its starting point the fact that the users of financial statements that have the most comprehensive need for information about the entity are those that stand last-in-line for distributions. It deduced from this that the most useful way in which equity can be distinguished from non-equity is by distinguishing the capital of those last in line (in other words, those holding the capital that directly absorbs losses of the business as a whole) from other capital. It called this approach the 'loss absorption approach'. A discussion paper Distinguishing between liabilities and equity setting out the analysis and describing the loss absorption approach was published in January 2008. Comments on the paper were invited, and the German standard-setter provided a summary of the comments received to the IASB as input to its own deliberations.

PERFORMANCE REPORTING

Another long-term PAAinE project that is coming an end is the project on Performance Reporting. Although this project has been following the joint IASB/FASB project on Financial Statement Presentation, the main focus of the PAAinE project has been on the net income/other comprehensive income issue. Originally the expectation was that the two Boards would issue a discussion paper on this subject in 2008, but the Boards narrowed the focus of their work and, as a result, are now unlikely to address the issue for a few years. Nevertheless, as the question of whether—and if so why—the existing net income/other comprehensive income reporting model should be retained or abandoned is the subject of more myths and misconceptions than most accounting issues, the objective of the PAAinE project has been to identify the real issues involved and to stimulate a debate within Europe on those real issues.

The project is being carried out in two phases, each of which will result in the publication of a discussion paper. The first paper—*The Performance Reporting Debate: What (if anything) is wrong with the good old income statement?*—was issued in late 2006. That paper looked behind the claims and counterclaims often made about the current performance reporting model and about the need for fundamental changes to the model, and it identified a number of key issues for further analysis.

Comment was invited on that paper and the comments received were used as input in the second phase of the project, which has been analysing the key issues identified in the first paper. (A summary of the comments received was also issued in February 2009.) That second phase resulted in a further paper *(Performance reporting: A European Discussion Paper)*, which was issued in March 2009.

- That second paper observes that there is no generally accepted detailed meaning of the term 'performance'—performance is a multi-faceted issue that cannot be encompassed in one or a few numbers—and that it therefore follows that net income does not capture an entity's performance.

- The paper notes that there is nevertheless a need for key lines (ie sub-totals) to help preparers in the communication process and to provide users with a starting point for analysis. It is therefore important that items of income and expenses are disaggregated, grouped and aggregated (the disaggregation model) in a way that provides the most useful key lines.

- The paper also considers whether there is a need for the bottom line of a performance statement to be a key line (because if there is, that would probably mean having two performance statements). However, the paper finds no evidence that it is necessary; the important thing is to use the right disaggregation model. As the need for recycling is also determined by the disaggregation model chosen, the paper reasons that the only performance reporting issue that really matters is the choice of disaggregation.

- The paper ends by saying that, rather than focusing on issues like the nature of performance, the number of performance statements, and recycling, Europe needs to thoroughly engage in the most important performance reporting debate of all—which is about disaggregation.

PENSIONS

The PAAinE project on Pensions, which is being led by staff of the UK national standard-setter, started back in 2005. Unlike the current IASB project on the subject, which is a quick-fix project, the objective of PAAinE project is to reconsider the fundamental principles of pension accounting with a view to contributing to the development of improved international standard on the subject. It seeks in particular to address the following matters:

- How best to reflect the relationship between an employer and a pension scheme in the employer's financial statements;

- How to recognise and measure the employer's assets held to pay pension benefits as well as the pension liabilities;

- How best to reflect movements in the value of plan assets and pension liabilities in the statement of financial performance;

- Consolidation of pension funds;

- Whether disclosure required by current standards are sufficient and appropriate;

- Financial reporting by pension schemes.

A PAAinE discussion paper The Financial Reporting of Pensions was issued in January 2008 setting out the tentative views of the UK standard-setter. In summary, those views are as follows:

- The pension liability—A liability for pensions arises in exchange for an employee's services as those services are provided. The liability should include all benefits to which there is a present commitment (whether through a legal or a constructive obligation), but should not include benefits that are genuinely discretionary.

- Whose liability is it?—The liability may be retained by the employer (as is often the case in Germany, for instance); passed to another party such as an insurance company; or rest with a pension plan sponsored by the employer. In the last instance, the employer should report a liability only in respect of any guarantee it has given—typically the amount by which the liability to pay benefits exceeds the amount of assets in the plan.

- Consolidation of pension plans—If the employer controls the plan, it should consolidate the plan in the employer's financial statements.

- Changes in surpluses and deficits—All changes in the amounts of pension deficits and surpluses should be reported in the period in which they arise. Approaches that permit or require some of these changes not to be reported in the primary financial statements or to be spread over a number of accounting periods (such as IAS 19's corridor approach) have no principled basis, give rise to considerable complexity and impair transparency.

- Measuring the liability using a risk-free rate—The liability should be quantified for financial reporting purposes at an assessment of the cost of settling the benefit, which will typically reflect all future cash flows (including the expenses of administering the liability). Information about the riskiness of the liability is better conveyed by disclosure than by adjustment to the amount of the liability, and so the cash flows should be discounted at a risk-free rate. The rate should not be increased to reflect the credit risk of the liability.

- Assets and the return on assets—Assets held in order to fund pension benefits should be reported at a current value. The actual return (including both dividends and changes in the value of the assets held) should be reported in the financial statements, and that information on the expected return should be provided by disclosure only.

- The income statement—Part of the change in a pension liability in an accounting period is due to service received and changes made to benefits: this should be reported in the income statement within operating activities. The return on assets and the finance cost relating to the liability (the unwinding of the discount) should be reported in financing, as should the effect of a change in the discount rate. Other changes relate primarily to changes in assumptions and should be reported as income or expenses, but not as part of operating activities or financing.

The project team is currently analysing the comments received in response to the PAAinE paper and deciding how to proceed.

REVENUE RECOGNITION

In last year's annual review we reported that the IASB and FASB were expected to issue a joint discussion paper on Revenue Recognition, and that discussion paper was likely to raise some fundamental issues about how revenue and gains should be accounted for, and could have major implications for accounting in the future. Recognising this, the German national standard-setter and EFRAG decided to start a debate within Europe on the issues involved by carrying out a PAAinE project on the subject. A PAAinE Discussion Paper Revenue recognition: A European Contribution was eventually issued in July 2007.

In 2008 the project team prepared a summary of the comments received in response to the PAAinE paper, and that summary was issued in February. A further presentation of the ideas in the PAAinE paper was also given to a joint meeting of the IASB and FASB. Attention then turned to the two Boards' own proposals, which were finally issued in a Discussion paper Preliminary Views on Revenue Recognition in Contracts with Customers in December 2008.

APPENDICES

TABLE 1 - FOUNDING FATHERS / MEMBER BODIES

EFRAG is a private sector body established by European organisations prominent in European capital markets, known collectively as the 'Founding Fathers / Member Bodies':

BUSINESSEUROPE	European Business Federations
FEE	Federation of European Accountants
CEA	European Insurance Organisation
EFFAS	European Federation of Financial Analyst Societies
EBF	European Banking Federation
ESBG	European Savings Banks Group
EACB	European Association of Co-operative Banks
EFAA	European Federation of Accountants and Auditors

TABLE 2 - SUPERVISORY BOARD

The members of the Supervisory Board are:

Göran Tidström, Chairman	PwC Sweden	**David Lindsell**	FEE
Javier De Frutos	EFFAS	**Patrice Marteau**	BUSINESSEUROPE
Chris De Noose	ESBG/WSBI	**Guido Ravoet**	EBF
Hervé Guider	EACB	**Peter Sampers**	BUSINESSEUROPE
Robin Jarvis	EFAA/UEAPME	**Gérard de la Martinière**	CEA
Klaus-Günther Klein	FEE	**Hans van Damme**	FEE

The advisers of the Supervisory Board members are:

Erik Berggren	BUSINESSEUROPE	**Roger Kaiser**	EBF
Alberto Corinti	CEA	**Saskia Slomp**	FEE
Astrid Hagenah	ESBG		

The European Commission attends the meeting as an observer.

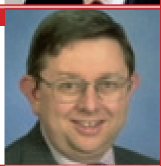
Henri Olivier (FEE) is Secretary to the Supervisory Board.

TABLE 3 - TECHNICAL EXPERT GROUP

Stig Enevoldsen (Denmark)
EFRAG TEG Chairman
Partner Deloitte

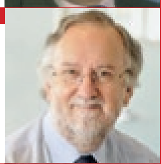
Françoise Flores (France)
EFRAG Vice-Chairwoman
Co-Chairwoman SME WG
Chairwoman Performance Reporting
Partner Mazars

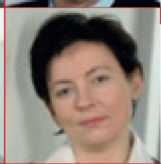
Mike Ashley (United Kingdom)
Chairman Financial Instruments Working Group
Audit partner KPMG



Thomas Seeberg (Germany)
Former CFO Osram GmbH

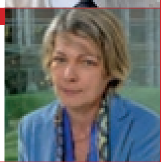
Alan Dangerfield (Switzerland)
Head of Corporate Finance Accounting &
Controlling – External Relations
Roche

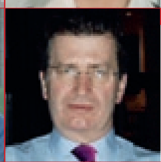




Anna Sirocka (Poland)
Audit Partner Ernst & Young

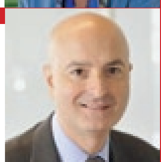
Catherine Guttmann (France)
Former Partner Deloitte

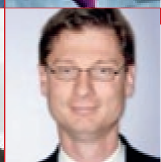




Michael Starkie (United Kingdom)
Group Vice President and Chief Accounting
Officer at BP p.l.c.

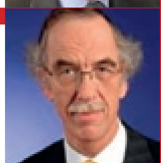
Roberto Monachino (Italy)
Director at UniCredit Banca Mobiliare





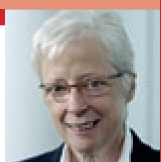
Carsten Zielke (Germany)
Managing Director at Société Generale

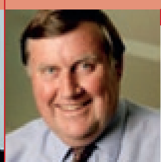
Hans Schoen (The Netherlands)
Former Audit partner KPMG



NON VOTING MEMBERS:

Liesel Knorr (Germany)
President German Accounting
Standards Board (GASB)





Ian Mackintosh (United Kingdom)
Chairman UK Accounting Standards
Board (UK ASB)

Jean-François Lepetit (France)
Chairman French Standard-Setter
(CNC)

The European Commission,
the IASB and CESR attend the
meeting as observers

TABLE 4 - SECRETARIAT AS OF 31 DECEMBER 2008

Stig Enevoldsen	EFRAG Chairman and CEO	**Charlotte Norre**	Project Manager
Paul Ebling	Technical Director	**Aleš Novak**	Project Manager
Sigvard Heurlin	Senior Project Manager	**Rasmus Sommer**	Project Manager
Mark Abela	Project Manager	**Frederiek Vermeulen**	Project Manager
Isabel Batista	Project Manager	**Jeff Waldier**	Project Manager
Svetlana Boysen	Project Manager	**Nathalie Saintmard**	Office Manager
Emmanuel Gagneux	Project Manager		

EFRAG would like to thank Nico Deprez, Greg Hodgkiss, Sven Morich, Nasreen Vadachia and Thomas Oversberg for their valuable contributions as project managers and support in the daily operations of EFRAG.

TABLE 5 – EFRAG OBSERVERS OF IASB WORKING GROUPS

Mike Ashley	Financial Instruments	**Andrew Lennard**	Pensions
Carsten Zielke	Insurance	**Performance Reporting**	Performance Reporting
Dominique Thouvenin	Leasing	**Francoise Flores**	IFRS for SMEs

TABLE 6 - MEMBERS OF THE FINANCIAL INSTRUMENTS WORKING GROUP

Mike Ashley - TEG Member and Working Group Chairman; David Bradbery - Preparer (UBS Investment Bank); Isabelle Collignon – Preparer (Crédit Agricole SA); Yvonne Wiehaegen-Knopke – Preparer (DZ BANK); Petri Hofste - Preparer (ABN AMRO); Gordon Ireland - Auditor (PWC); Roberto Monachino - TEG Member; Massimo Romano - Preparer (Assicurazioni Generali); Hugh Shields - Preparer (Barclays Capital); Agnes Tardos - Auditor (PWC); Svetlana Boysen (EFRAG); Paul Ebling (EFRAG). In addition the European Commission, CESR and CEBS are given observer seats.

TABLE 7 - MEMBERS OF THE INSURANCE ACCOUNTING WORKING GROUP

Benoît Jaspar – Working Group Chairman - Preparer (Assicurazioni Generali); Bernard Bolle-Reddat – Preparer (BNP-Paribas); Inge Beicher – Preparer (Danskebank); Hugh Francis – Preparer (AVIVA); Catherine Guttmann - TEG Member; Jean d'Herbécourt - preparer (Société Générale); Joachim Kölschbach – Auditor (KPMG); Jacques Le Douit – Preparer (AXA); Nigel Masters – Preparer (Zurich Financial Services); Ruurd Van den Berg – Preparer (AEGON); Carsten Zielke - TEG Member; Paul Ebling (EFRAG). In addition the European Commission, CESR, CEIOPS and CEA are given observer seats. ICISA, ACME and the Reinsurance industry are associate members of the working group.

TABLE 8 - MEMBERS OF THE JOINT WORKING GROUP ON IFRS FOR SME

Françoise Flores - TEG Member and Co-Chairwoman SME WG; Hans van Damme - Co-Chairman SME Working Group - Auditor (FEE); Luisa Anacoreta, Academic (Universidade Catholica Editora, Lisboa); Piotr Banas – EC; Kati Beiersdorf (German Standard-Setter); Reinhard Biebel – EC; Manfred Bolin – German standard setter (DRSC); Dirk Bolte – User (Prüfungsstelle des Hanseatischen Sparkassen- und Giroverbandes); Jean-Pierre Boucquet - User (Dexia); José Maria Bové - Auditor (Bové Montero y Cia); John Bowen-Walsh - Auditor (ICAI); Carl-Gustaf Burén - Preparer (Svenkst Näringsliv); Jérôme Chevy - French Standard-Setter (CNC); Jill Collis, Academic (Kingston University, London); Isabelle Ferrand - Preparer (CNCM); Cornelia Flury - Auditor (IDW); Christoph Frank – SME Preparer (ZDH); Henri Giot - Auditor (OEC); Franz Gross - Preparer (Österreichischer Genossenschaftsverband); Signe Haakanes - Auditor (Den Norske Revisorforening); Alexander Hadjinenkov - Preparer (EACB); Jorge Herreros - Auditor (KPMG); Robin Jarvis - EFRAG SB Member – Auditor (ACCA); Kristian Koktvedgaard – Preparer (BUSINESSEUROPE); Ulf Linder – EC; Dora Majoros – EC; Felix Mayrhofer - User (Sparkassen-Prüfungsverband); Jens Poll - Auditor (Dres Brönner Treuhand-Revision); Gerhard Prachner - Auditor (PWC); Silvia Prasse - Preparer (BDI); Päivi Räty - Preparer (CFIE); Isobel Sharp - Auditor (Deloitte); Nigel Sleigh-Johnson - Auditor; Saskia Slomp (FEE); Kees Streefkerk - Preparer (SHV Holdings); Hugo Van Den Ende – Dutch standard setter (DASB); Willem Van Leeuwen - Preparer (SHV Holding); Leyre Fuertes (FEE); Sven Morich (EFRAG); Charlotte Norre (EFRAG).

TABLE 9 - PAAinE CONCEPTUAL FRAMEWORK ADVISORY GROUP

Bernard Colasse - Working Group Chairman - Academic (Université Paris Dauphine); Dominique Bonsergent – Preparer (Total SA) ; Jerome Chevy (CNC); Ole Michaël Friis – Academic (University of Southern Denmark); Rolf Uwe Fülbier – Academic (WHU - Otto Beisheim School of Management); Seema Jamil-O'Neill (UK ASB); Steinar Sars Kvifte – Auditor (Norwegian Financial Reporting Group); Laima Kazlauskiene - Lithuanian Standard Setter (IARL); Ugo Marinelli – Academic (OIC); Philip Staines (CNC); Enrique Villanueva – Academic (Universidad Complutense de Madrid); Paul Ebling (EFRAG); Sigvard Heurlin (EFRAG). The European Commission has been given observer seats.

TABLE 10 - PAAinE PERFORMANCE REPORTING ADVISORY GROUP

Françoise Flores - TEG Member and Working Group Chairwoman; Janina Bogajewskaja - German Standard Setter (GASB); Michele Casó – Academic (Università Bocconi); Nadia Chebotareva – Auditor (Deloitte); Alan Dangerfield – Preparer (Roche Group); Helena Isidro – Academic (ISCTE); Andrew Lennard – UK Standard Setter (UK ASB); Karolien Melody – Preparer (Aegon); Walter Schuster – Academic (Stockholm School of Economics); Getruda Swiderska – Academic (Warsaw School of Economics); Milos Tumpach – Academic (University of Economics Bratislava); Jose Luis Ucieda – Academic (University of Madrid); Wolfgang Weber – Banker (Deutsche Bank AB); Peter Westlake – User (UK ASB); Gilles Zancanaro – Preparer (Bouygues Corporate). The European Commission has been given observer seats.

TABLE 11 - PAAinE PENSIONS ADVISORY GROUP

Andrew Lennard – Working Group Chairman – UK Standard Setter (UK ASB); Luis Bautista Jiménez - Spanish DG of Insurance and Pension Funds; Laima Kazlauskiene - Lithuanian Standard Setter (IARL); Finn Kinserdal – User (Borea); Christoph Krischanitz – Consultant (Arithmetica Versicherungs und Finanzmathematische Beratungs GmbH); Ugo Marinelli – Academic; Raimund Rhiel – Consultant (MERCER Human Resource Consulting GmbH); Philip Staines - French Standard Setter (CNC); Guus van Eimeren – Auditor (KPMG); Paul Ebling (EFRAG). The European Commission has been given observer seats.

THE EFRAG SECRETARIAT

ANNUAL REVIEW 2008

EFRAG
Square de Meeûs 35
B-1000 Brussels
T +32-2 210 44 00 ▪ F +32-2 210 44 01
info@efrag.org

WWW.EFRAG.ORG