EFRAG

European Financial Reporting Advisory Group

25 November 2009

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

Dear Sir/ Madam

IASB ED *Improvements to IFRSs*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft *Improvements to IFRSs* ('the ED'). This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive interpretations/amendments on the issues.

Our detailed comments on the ED are set out in the appendices to this letter. (In Appendix 1 we comment on each issue addressed in the ED; and in Appendix 2 we respond to the specific questions asked in the ED.) To summarise, we agree in principle with most of the proposals in the ED, although we sometimes raise some detailed issues or see a need for some rewording or for additional amendments to make the issue clearer. However:

- we do not support the proposed transitional provisions for the proposed amendment to IFRS 5 (Issue 6). We think the effective date should be deferred a year;
- we are not able to support the proposed amendment to IAS 8 to reflect the yet-to-be-issued revisions to the Framework (Issue 9). We agree though that as soon as possible after the revised Framework has been issued amendments should be made to IAS 8 to reflect the main revisions;
- we do not support the proposal to amend paragraph 38(b) of IAS 27 by replacing the words "in accordance with IAS 39" with "at fair value through profit or loss". (This amendment is part of issue 10). In our view existing IFRS permits investments in subsidiaries, jointly controlled entities and joint ventures to be measured in the investor's separate financial statements at fair value through other comprehensive income and that option should be retained;
- we are concerned about the proposal to include the word 'each' in paragraph 38 of IAS 27, because we think it could have the effect of restricting the availability of the

cost model and we do not support such a restriction. (This amendment is also part of Issue 10);

- we do not support finalisation of the amendment to IAS 40 without a comprehensive analysis of all the related issues being carried out (Issue 14).

We hope that you find the comments helpful. If you wish to discuss them further, please do not hesitate to contact Stuart Studsrud or me.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix 1
EFRAG's detailed comments on the amendments proposed

Issue 1: IFRS1 First-time Adoption of IFRSs – Accounting policy changes in the year of adoption

1 EFRAG agrees that this is an issue that requires clarification. We also agree with the IASB's observations and conclusions, and we agree that the amendments proposed fully reflect those observations and conclusions. We therefore support the proposed amendments.

Issue 2: IFRS1 First-time Adoption of IFRSs - Revaluation basis as deemed cost

2 EFRAG agrees that this is an issue that requires clarification, it agrees with the IASB's reasoning for proposing that the exemption should be broadened, and it agrees with the amendment proposed.

Issue 3: IFRS 3 (2008) *Business Combinations* - Transition requirements for consequential amendments of IFRS 3 to IFRS 7, IAS 32 and IAS 39 for contingent consideration from a business combination that occurred before the effective date of the revised standard.

3 EFRAG agrees with the IASB's decision to address this issue. We also agree in principle with the amendments proposed because they adopt an approach that is consistent with the spirit of the revised IFRS 3, which is to be applied prospectively and prohibits changes to assets and liabilities that arose in business combinations that occurred prior to its adoption.

4 Having said that, we have some concerns with the potential legal implications of the proposed amendments, because they refer specifically to paragraphs of old IFRS 3 (ie IFRS 3 as revised in 2004). Those paragraphs and that standard no longer exist in "IFRSs as endorsed in Europe"; old IFRS 3 was withdrawn when revised IFRS 3 was endorsed. We think one way to resolve this problem is to insert into revised IFRS 3—as an additional paragraph after paragraph 67—wording based on the paragraphs in 'old' IFRS 3 that are being referred to.

5 We also have a second, much broader, concern. This concern relates to the use of terminology such as 'prospective' transition versus 'retrospective' transition. The IASB sometimes defines or describes prospective application in different ways. To us, it is not always clear what the IASB means by "prospective" transition and how it should be applied. In our view, the IASB should think about developing a clear definition of what it intends "prospective" and "retrospective" to mean and how it ought to be applied, with exceptions to the 'standard definition' made only when it is absolutely necessary. Having a clear set of definitions is likely to diminish the number of questions that the IASB /IFRIC receive on transition of IFRSs.

Issue 4: IFRS 3 (2008) *Business Combinations* - Measuring Non-Controlling Interests

6 First, we are somewhat puzzled to hear that the issue has arisen as a result of the revisions made to the definition of Non Controlling Interests (NCI), as we do not believe that the change in definition has widened its scope. Nonetheless, it is troubling that some are measuring certain components of equity, such as share-based payment arrangements, at nil at the date of the acquisition in a business combination under the revised IFRS 3, because such accounting is not consistent with the standard on business combinations. Therefore, if the revised IFRS 3 is unclear in this respect, we agree that it should be fixed.

7 We also support the effective date and the transition requirements proposed.

8 However, we have some detailed comments.

(a) First of all, we are concerned about the wording of the amendment proposed, because we think the words "NCI that are present ownership instruments and entitle their holders to a pro rata share of the entity's net assets" might not capture all those elements of NCI that the IASB intends it to capture. For example, it is not clear to us that the term "on liquidation" would be interpreted in the same in all IFRS jurisdictions. This term might itself need to be defined to ensure consistent application.

(b) We recommend the IASB to clearly articulate in the Basis for Conclusions what the real issue is and why it has arisen, so that constituents can clearly understand whether the amendment as drafted poses a solution, without bringing on other uncertainties. In our view, as it stands, the rationale behind the amendment is not clearly articulated so it is difficult for us to comment in detail on whether the drafting is appropriate.

(c) We also wonder whether the IASB should amend paragraph 18 of the revised IFRS 3 to clarify that on acquisition date an acquirer shall measure identifiable assets and liabilities <u>and equity instruments</u> at fair value, unless an exception to fair value is provided in IFRS 3.

Issue 5: IFRS 3 (2008) *Business Combinations* - Un-replaced and voluntarily replaced share-based payment awards

9 EFRAG agrees that it is useful to address the above mentioned topics to prevent diverging practices to arise. We support the amendments proposed.

10 We also think that it may be useful to address the case when the replacement awards market-based value at acquisition date is lower than the portion of the replaced awards' value that is attributable to pre-combination service.

11 We also have one drafting suggestion: the ED proposes adding a footnote explaining the use of the term 'share-based payment awards' in "paragraphs B56-B62B". However, the term 'share-based payment awards' is not used in the paragraphs B62A and B62B, so we think the footnote should refer only to paragraphs B56-B62.

Issue 6: IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* – Application of IFRS 5 in loss of significant influence over an associate or a jointly controlled entity

12 EFRAG agrees that clarification is necessary and that an amendment is an appropriate means to achieve this. However, we think the proposed redrafting could be improved:

> An entity that is committed to a sale plan involving loss of control, <u>significant influence or joint control</u> of a subsidiary<u>, an associate or a jointly controlled entity respectively</u> shall classify all the assets and liabilities of that subsidiary <u>or all the interests in an associate or a jointly controlled entity</u> as held for sale when the criteria set out in paragraphs 6-8 are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary or an interest in the former associate or jointly controlled entity after the sale.

13 EFRAG understands that the intention of this amendment is to provide useful information to users relating to future cash flows from non-current assets. There is a question relating to the interaction of this amendment and those proposed in issue 12 relating to IAS 28 *Investments in Associates*. As the investment in associate is clearly split into separate investments (one carried at fair value and the other according to the equity method), the different portions will be disclosed separately from one another. We think the intention is that the provisions of IFRS 5 will apply only to the equity accounted portion of the investment (in accordance with the business model approach applied in this instance) as the fair value information provided by the remainder of the investment already provides sufficient information relating to future cash flows. However, this is not clear from the current wording. We suggest that this should be clarified in the final amendment.

Issue 7: IFRS 7 *Financial Instruments: Disclosures* – Disclosures about the nature and extent of risks arising from financial instruments

14 EFRAG agrees with the IASB's proposal to make the above amendments as part of the Annual Improvement Project. We also agree with the proposed transitional provisions.

15 We have however some comments on the proposed amendment to paragraph 36(a), which seeks to clarify the requirement to disclose information about the maximum exposure to credit risk that applies to financial assets whose carrying amounts do not reflect the reporting entity's maximum exposure to credit risk. We believe that, if users are to understand what the disclosed maximum exposure to credit risk relates to and how much of the total carrying amount of financial instruments with credit risk exposure is representative of maximum exposure to credit risk, it is necessary also to disclose the carrying amount of such instruments. For example, assume an entity has a total carrying amount of financial instruments with credit risk exposure of CU100, out of which CU60 reflects the entity's maximum exposure to credit risk and CU40 does not. In accordance with the amendment the entity would be required to

disclose the maximum credit risk exposure arising from financial instruments (which may be 80CU for example) whose carrying amount is CU40. We believe it is necessary to disclose that the carrying amount of those instruments is CU40 in order for the information to be useful. This would enable users to understand that CU 60 is representative of the maximum credit risk exposure and CU 40 is not.

Issue 8: IAS 1 *Presentation of Financial Statements* – Clarification of statement of changes in equity

16 EFRAG agrees with the IASB's assessment of the issues identified and the objectives of the amendments. We also agree with the proposed effective date and transition provisions. However:

(a) we believe that, under the proposed revised wording of paragraph IAS 1.106, it will be possible for an entity to present *all* the items required in IAS 1.106 in the notes; in other words, it will be possible to present the whole 'statement of changes in equity' in the notes rather than as a primary financial statement. This would be inconsistent with IAS 1.10. As the objective is to make it clear that paragraph 106(d)(ii) does <u>not</u> require the separate presentation of each class of accumulated OCI on the face of the statement of changes in equity, we suggest an alternative amendment: adding to the existing IAS 1.106 a sentence such as: "The information required in IAS 1.106(d)(ii) may be shown in the notes to the statement of changes in equity."

(b) we believe that the proposed amendment to IAS 1.107 eliminates the requirement to show the amount of <u>dividends</u> recognised as distributions to owners during a period (because IAS 1.106(d)(iii) only requires an entity to show <u>distributions to owners</u> separately). The amount of distributions to owners will obviously include the amount of dividends, but might also contain additional amounts resulting from other forms of distributions to owners and, in such cases, the amount of dividends distributed to owners in a period will be found neither in the statement of changes in equity nor in the notes. Since we doubt that this is the intention of the proposed amendment to IAS 1.107, we suggest including a requirement to separate the amount of possible other forms of distributions to owners from the amount of dividends.

17 Finally, although we agree that the issues being addressed could be resolved as part of the 2009 Annual Improvements Project, we question whether, bearing in mind the IASB already has an active project looking more comprehensively at OCI presentation, the issues being addressed here are sufficiently important and urgent to be addressed in advance of that more comprehensive piece of work.

Issue 9: IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* – Update for conceptual framework terminology changes

18 As it happens, EFRAG has, in its comment letters on the IASB's Framework project, argued against making the changes to the qualitative characteristics that are behind this amendment. However, putting that aside, we agree that the IASB:

(a) should not immediately amend all existing standards so they are in accordance with the terminology in the revised chapters of the Framework; but

(b) should nevertheless make an exception for the requirements in IAS 8 relating to selection and application of accounting policies in the absence of an IFRS that specifically applies to that transaction, other event or condition, so that those requirements are brought immediately into line with the revised Framework. This also applies for the requirements stating when an entity shall change an accounting policy and the resulting disclosure requirements.

19 However, as the revised Framework has not been issued yet, we are currently not able to assess whether the proposed amendment to IAS 8 reflects these new chapters. Accordingly, we cannot support the suggested amendment to IAS 8 at the present time. We would therefore encourage the IASB to re-propose the amendment when the relevant chapters of the revised Framework have been issued.

20 More generally, we think it would have been preferable had essential amendments to IFRS of this kind been issued in draft form as part of, or alongside, the Framework ED. This would have helped constituents of the IASB to understand some of the implications of the proposed Framework changes.

Issue 10: IAS 27 *Consolidated and Separate Financial Statements* – impairment of investments in subsidiaries, jointly controlled entities and associates in the separate financial statements of the investor

21 The Amendment addresses several aspects of the accounting for investments in subsidiaries, joint ventures and associates in the separate financial statements of the investor. Our comments on these matters are discussed below.

Impairment: Should the provisions of IAS 36 or the provisions of IAS 39 apply?

22 We agree that this is an issue that needs to be clarified, and that the Annual Improvements Project is an appropriate place in which to provide that clarification. We also support the proposal that IAS 39’s impairment test shall be applied, and we support the proposed insertion into IAS 27 of paragraph 38D to achieve that end. That is because we believe that, in the separate financial statements of the investor, investments in subsidiaries, jointly controlled entities and associates should be tested for impairment as “stand-alone” investments in the same way as other equity instruments. This means the impairment provisions in IAS 39 should be applied to such investments, regardless of whether they are carried at cost or at fair value (as permitted by IAS 27).

23 We recognise that one implication of this is that the impairment model used in the separate financial statements will not be the same as the impairment model used in the consolidated financial statements. However, we do not believe that this need be a concern because the purpose of the two sets of financial statements is different.

Measurement at fair value in accordance with IAS 39

24 Another of the proposed amendments is to paragraph 38 so that the measurement options are cost or fair value through profit or loss.”. We do not agree with this.

25 It is our understanding that the existing wording of paragraph 38(b) of IAS 27 is widely interpreted to mean that investments falling within the scope of the paragraph

can be accounted for either at fair value through profit or loss or at fair value through other comprehensive income (OCI). For those interpreting the text in this way, the proposed amendment will have the effect of eliminating the fair value through OCI option. Yet the ED contains no reasoning or explanation for the change. We do not believe it is appropriate to restrict the way in which an entity applies IAS 39 to such investments and we are strongly against any such change being made without the reasoning for the change being explained.

26 We understand that the IASB does not believe it is changing existing IFRS because it believes the words of the existing Basis for Conclusions make it clear that the IASB always intended the words "in accordance with IAS 39" to mean "at fair value through profit or loss". It is not for us to comment on what the IASB's intentions were when, in 2003, it last changed this part of IAS 27, but we would observe that:

(a) users of IFRSs cannot reasonably be expected to do any more than comply with the spirit of the standards as written. Those standards as written refer to compliance with IAS 39, not just one of the options available in IAS 39; and that is how the standards are being widely applied; and

(b) paragraph BC65 of IAS 27 explains that, prior to the changes made in 2003, the standard permitted investments in subsidiaries to be measured in a parent's separate financial statements at cost, using the equity method or "as available-for-sale financial assets in accordance with IAS 39". However, in 2003 "the Board decided to [amend the standard to] require use of cost or IAS 39". Paragraph BC66 explains why the Board decided to omit the option to apply the equity method option, but there is no suggestion that there has been any change in the availability of the available-for-sale option. Taken together, these paragraphs have been widely viewed as confirming that the only change made in 2003 to paragraph 29 of IAS 27 as revised in 2000 was to eliminate the equity method option; the option to account for the investments as available-for-sale financial assets remained.

27 We think that the proposed insertion of the word 'each' in paragraph 38(b) could be interpreted to mean that both options (cost and fair value) are to be applied in accordance with IAS 39 and thus that cost can be applied only in the circumstances in which IAS 39 permits or requires it to be used. (In IAS 39 an entity can apply the cost model for equity investments only if the equity investment is unlisted and it is deemed not possible to "reliably estimate" fair value. Such an interpretation would represent a significant change to existing IFRS. We would not support such a change because we do not support limiting the use of the cost approach for investments in subsidiaries, joint ventures and associates in the separate accounts of the investor, as is currently permitted in existing IAS 27. We recommend that the IASB clarifies that the amendment is not intended to limit the use of the cost approach in any way.

Issue 11: IAS 27 *Consolidated and Separate Financial Statements* – Transition requirements for consequential amendments of IAS 27 to IAS 21, IAS 28 and IAS 31

28 EFRAG agrees that this is an issue that requires clarification. We also agree with the amendments proposed. Because IAS 27 requires prospective application, it seems logical for the amendments to IASs 21, 28 and 31 to also be applied prospectively.

29 EFRAG believes that the intention is that the amendment to IAS 39 should also be applied prospectively but, because that amendment refers to paragraphs of IAS 21 that are also being amended by amended IAS 27 and those amendments to IAS 21 are to be applied prospectively, the IASB has taken the view that it is not necessary to also make it clear that IAS 39 should be applied prospectively.

Issue 12: IAS 28 *Investments in Associates* – Partial use of fair value for measurement of associates

30 EFRAG agrees with the IASB's assessment of the issues and with its tentative decision. There is a divergence of views in practice as to whether different measurement bases can be applied to different portions of an investment in an associate when part of the investment is designated at initial recognition as at fair value through profit or loss, with:

(a) some believing that it is necessary to identify all direct and indirect interests held in the associate by either the parent or any of its subsidiaries and apply IAS 28 to the entire investment in the associate; and

(b) others believing it is necessary to identify all direct and indirect interests held in the associate, but use the scope criteria in IAS 28 to determine the allowed accounting treatments for the investment (or a portion of the investment).

31 We think that the approach described in (a) could create accounting mismatches. Furthermore, EFRAG is in favour of business purpose/business model concepts being used in accounting and approach (b) does that. In addition, as argued in the Basis for Conclusion of IAS 28, the equity method for investments held by venture capital organisations, mutual funds, unit trusts and similar entities often produces information that is not relevant to their management and investors; fair value measurement produces more relevant information. Therefore it seems reasonable that even at the group level the fair value through profit or loss shall be applied to the portion of an investment held by the previously mentioned subsidiaries to which the scope exclusion of IAS 28 applies.

32 EFRAG also agrees with the IASB's conclusion that the issues should be resolved as part of the 2009 Annual Improvements Project and with the effective date and transitional provisions. However we note that proposed paragraph 41E of IAS 28 does not specify if the amendment to the scope of the standard should be applied retrospectively or prospectively. Presumably the intention is that the amendment should be made retrospectively in accordance with IAS 8, but we think it would be helpful if this could be clarified.

33 Having said that, EFRAG believes some practical issues may arise from the amendments being proposed. These include, for example, whether and when transfers can be made between the portion accounted for at fair value through profit or loss and the portion accounted for based on the equity method. We would ask the IASB to provide guidance and consider re-exposure including the guidance.

Issue 13: IAS 34 *Interim Financial Reporting* – Significant events and transactions

34 Even though IAS 34 does not require specific fair value and reclassification disclosures for condensed interim financial reports, it provides a clear principle for determining whether and when fair value disclosures would be required. Therefore, depending on the circumstances and the significance of those circumstances to the understanding of their financial position and performance, entities might be required to disclose information similar to disclosures required by IFRS 7. However, in the time of the crisis it is hard to argue against the enhanced disclosure requirements, especially in the field of fair value measurements and reclassification. In addition, the proposed amendment would align IAS 34 requirements with the changes introduced by the FASB FSPs issued in April 2009. EFRAG hence agrees with the proposed amendment.

35 We note that the language in paragraph 15B is not consistent, in that in certain instances the events and transactions include a reference to 'significant' and in certain other instances (paragraphs 15B(l) and 15B(m), for example) there is no such reference even though it seems equally appropriate. We suggest that the detailed drafting of the paragraph is reviewed.

36 EFRAG also agrees with the effective date and transitional provisions.

Issue 14: Proposed amendment to IAS 40 *Investment Property* – Changes from fair value model to cost model

37 We do not have any strong views as to whether a change of the kind proposed should be made through the Annual Improvement Project or through a separate project, even though we believe the change proposed could have significant practical implications for some reporting entities. However, we think the issue being addressed is a complex one that raises a number of additional issues and, as a result, we think it would be preferable if the IASB delayed finalisation of the amendment so that it can consider the matter—including the related issues and consequences of the changes proposed—comprehensively. It follows that we are not in favour of the proposed amendment being taken forward in this round of Annual Improvements.

38 We believe that some of the issues that need to be addressed before finalisation are as follows:

(a) Contrary to what is argued in paragraph BC1 of the ED, we think existing IFRS is clear as to when investments properties should be measured in accordance with IAS 2 *Inventories* and when in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Therefore, in our view the issue is whether existing IFRS results in investment property being measured appropriately in all circumstances. We think this is an issue that needs to be explored more comprehensively. For example we think it would be useful to understand why it is more important to have consistency of treatment between property acquired as investment property but now being developed with a view to sale, investment property under construction and investment property that is redeveloped for continued use as investment property rather than between property acquired as investment property but now being developed with a view to sale and property acquired with a view to sale.

(b) Related to this is why the IASB believes a change in the purpose for which an investment property is being held should not be reflected in the financial statements. That is why a property originally held as investment property but where development with a view to sale has commenced should be accounted for differently than an investment property originally acquired for development with a view to sale.

(c) We are concerned that the analysis undertaken to date might have focused too much on the implications for investment properties measured at fair value (hence the title of the amendment ('change from fair value model to cost model') and paragraph BC3's reference continuing to measure the property using the measurement model previously selected in accordance with IAS 40 providing the most relevant information") and not enough on entities measuring investment properties using the cost model. Yet we suspect that the proposal could result in more entities having to change the measurement model used under IAS 40. Currently, when an entity, measuring investment properties using the cost model commences development with a view to sale, the investment property will also be measured at cost in accordance with IAS 2. However, we think the proposed amendment would lead to these investment properties having to be measured at fair value less cost to sell in accordance with IFRS 5—at least when the development has been completed and the criteria to be held for sale are met.

(d) We think it is also important to understand why the IFRS 5 disclosures are thought to be useful for investment properties that are to be disposed of but do not meet the criteria to be classified as held for sale, but are not thought to be useful in some other circumstances in which the held for sale criteria are not met.

Issue 15: IFRIC 13 Customer Loyalty Programmes – Fair value of award credits

39 EFRAG agrees that this is an issue that requires clarification. We also agree with the clarification proposed, and with the effective date and transition provisions.

40 However, we also believe that, unless the position is clarified, there will be diverging views on whether changes in practice resulting from the clarification should be treated as a change in accounting policy in accordance with IAS 8. We therefore think this too should be clarified.

Appendix 2
EFRAG's responses to the questions specifically asked in the ED

Question 1: Do you agree with the Board's proposal to amend IFRS as described in the exposure draft? If not, why and what alternative do you propose?

1 Please see our comments on each of the amendments proposed as set out in Appendix 1.

Question 2: Do you agree with the proposed transition provisions and effective date for the issue described in the exposure draft? If not, why and what alternative do you propose?

2 Please see our comments on each of the amendments proposed as set out in Appendix 1.

Question 3: Do you agree that the proposed amendment to IAS 34 to emphasise its disclosure principles is likely to lead to more useful information being made available to investors and other users of interim financial reports? If not, why? What would you propose instead and why?

3 As explained in our comments in Appendix 1 on Issue 13, we agree that the amendment is likely to lead to more useful information being made available to investors and other users of interim financial reports.

Question 4: Do you agree that the amendment to IAS 34 to require particular disclosures to be made in interim financial statements is a more effective way of ensuring that users of interim financial statements are provided with useful information?

4 As explained in our comments in Appendix 1 on Issue 13, we agree that the amendment is a more effective way of ensuring that users of interim financial statements are provided with useful information. We do have some concerns about the wording of the proposed amendment though, as explained in Appendix 1.

Question 5: Do you agree that the proposed amendment to IAS 40 should be included within *Improvements to IFRSs* or should a separate project be undertaken to address the issue? If you believe a separate project should be undertaken, please explain why.

5 As explained in our comments in Appendix 1 on Issue 14, although we do not think that it would be inappropriate to make the amendment proposed though the Annual Improvement Project, we are not in favour of it being made through this particular round of Annual Improvements because we believe a more extensive piece of work needs to be carried out before bringing forward any further amendments in this area.