Associazione Bancaria Italiana

ABI position paper on exposure draft of improvements to IFRS

January 2007

POSITION PAPER

1/2008

IAS/IFRS	Issues	ABI comments
IFRS 1 *First-time Adoption of International Financial Reporting Standards*	1. Restructuring of IFRS 1	We don't have comments.
IFRS 5 Non-current Assets Held for Sale and Discontinued Operations	2. Plan to sell the controlling interest in a subsidiary	The amendment intends to clarify that being committed to a plan involving the loss of control of a subsidiary triggers the classification of the subsidiary asset's liabilities as held for sale. We agree with the proposed amendments.
IFRS 7 Financial Instruments: Disclosures	3. Presentation of finance costs	The amendment intends to solve a potential inconsistency between IAS 1, that forbids offsetting income and expenses, and IFRS 7 that indicates that finance costs include interest income and expenses, thereby, allowing offsetting. In particular, the amendment clarifies that only interest expenses are a component of finance costs. We generally agree with the proposed amendments.

		According to the current Bank of Italy requirements, however, interest income and interest expenses were already separately disclosed in an income statement. We also note that by restricting item finance costs to interest expenses, the latter will be represented together with other finance costs while interest income apparently must be disclosed separately.
IAS 1 Presentation of Financial Statements	4. Statement of compliance with IFRSs	The amendment clarifies that when an entity refers to IFRSs as the basis of presentation of its financial statements but it's unable to make an explicit and unreserved statement of compliance with IFRSs because of some difference between "full IFRS" and the accounting standards actually applied, it should describe: a) each difference between the basis on which its financial statements are prepared and IFRSs that are applicable to its financial statements; and b) how its reported financial position and performance of the entity would have differed if it had complied with IFRSs.

		We agree that knowledge of accounting policies employed is important for users of financial statements. We're also aware of the fact that IFRSs are being adopted and are going to be adopted by many jurisdictions; however adoption of IFRSs by a specific jurisdiction is ruled by local regulations and accordingly differences may arise between IFRSs as issued by IASB and IFRSs as applied in country XY. Therefore we agree that disclosure of differences between IFRSs as applied in country XY and "full IFRS" can improve users' understanding of financial statements. Nonetheless we're worried that par. 16Ab) could be broadly interpreted as requiring a numerical estimate of the effects of adoption of full IFRSs. We oppose such view as one of the reasons for not endorsing IFRS/IAS could be the complexity of the rules proposed by the standards. Accordingly, while we support the

		requirement dictated by par. 16A letter a), we propose that the requirement of par. 16Ab) be removed.
	5. Current/non-current classification of convertible instruments	The amendment intends to clarify that liabilities convertible in equity whose maturity exceed 12 months are non-current liabilities even if conversion can be required on demand or in 12 months. It's our understanding that current/non-current classification of assets and liabilities aim to assess the entity's liquidity and solvency. As the conversion of liabilities in own equity doesn't require an outflow of economic benefit, it should be irrelevant to classify liabilities as current/non current. Accordingly we support the ED proposal.
	6. Current/non- current classification of derivatives	The amendments intend to clarify that not every held for trading financial assets and liabilities must be classified as "current". That would be, in particular, the case for financial derivatives and "short sales" that will be settled in more than 12 months. In our opinion, financial instruments held for trading should be generally classified as current as:

		- they are acquired or incurred for the purpose of selling or repurchasing them in the near term; - they are part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking. Whenever a derivative is part of a portfolio for which short-term profit taking applies or, it is associated with trading non derivatives asset/liability, it should be classified as current. For these reasons we don't agree with the ED proposal. On the other hand, derivatives employed for hedge accounting or associated with assets/liabilities classified in Fair Value Option should be classified as current or non current according to the maturity of the hedge relationship which is defined by the maturity of the derivative. In addition we agree with EFRAG that the proposed amendments will not achieve their aim. In fact both pars. 57 and 60 of IAS 1, that are not amended, state that "An asset (liability) shall be classified as

		current when it satisfies any of the following criteria: b) it is held primarily for the purpose of being traded".
IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors	7. Status of implementation guidance	The proposed amendment aims to clarify that the implementation guidance (IG) is not mandatory. We agree with the proposed amendments, even if IG, not being endorsed, aren't currently mandatory in Europe.
IAS 10 Events after the Reporting Period	8. Dividends declared after the end of the reporting period	The amendment intends to clarify that dividends declared after the end of the reporting period cannot be disclosed doesn't give rise to the recognition of a liability even if the entity has a past practice of paying such dividends. We agree that current guidance could be interpreted as requiring/allowing the recognition of a liability against dividends declared after the end of the reporting period if the entity has a past practice of paying dividends. In fact in such case it could be argued that a constructive obligation exists. We note that such dividends, however, are not considered for the purpose of calculating the regulatory capital for

		banks. We support the ED's proposal.
IAS 16 Property, Plant and Equipment	9. Recoverable amount	The amendment changes the definition of recoverable amount (from "higher of its net selling price and its value in use " to "higher of its fair value less cost to sell and its value in use") in order to align the definition with IAS 36 and IFRS 5. We agree with the amendment, however we agree with EFRAG that definition of recoverable amount in IAS 16 could be deleted as it's not employed by the standard.
	10. Sale of assets held for rental	The ED clarifies that gains arising from the sale of Property, Plant and Equipment (PPE) held for rental can be reported as revenue if the entity, in the course of its ordinary activities, routinely sells items of property, plant and equipment that it has held for rental to others. Current IAS 16 forbids the classification of such gain as revenue. We generally agree with the proposed amendments. However it's our opinion that the

		amendment should be extended to every kind of PPE held for use if they are routinely sold by the entity, in the course of its ordinary activities.
IAS 17 Leases	11. Classification of leases of land and buildings	The ED aims to modify the guidance in IAS 17 for classification of leases of land and building as operating or as finance leases. We support the proposed amendment as we agree that classification of land and building leases should assess the substance of the transaction without assessing only the passage of the ownership title of the land/building to the lessee by the end of the leasing. According to the new definition, passage of ownership to the lessee is one of the situations that have to be assessed in order to decide the proper classification.
	12. Contingent rents	The ED clarifies that contingent rents shall be recognized when incurred both for finance and for operating leases. We agree with the proposed amendment also for consistency reasons with the treatment of contingent rents for finance leases.

IAS 18 Revenue	13. Costs of originating a loan	The amendment aims to modify the guidance of IAS 18 in order to align the wording to IAS 39. In particular it indicates that the "direct costs" referred by paragraph 14 of the IAS 18 guidance are the transaction costs defined by IAS 39. We support the proposed guidance and we think that par. 14 letter a)ii should also be amended.
IAS 19 Employee Benefits	14. Curtailments and negative past service cost	The amendment clarifies that plan amendments that reduce existing benefits have to be considered as: - negative past service cost if the reduction relates to past service cost; - curtailments if the reduction affects benefits for future service. We support the proposed amendment.
	15. Plan administration costs	The ED amends the definition of return on plan assets in order to clarify that costs of administering the plan shall not be considered if they are included in the actuarial assumption employed for calculating the defined benefit obligation. We agree with the ED's proposal as it

		makes sure that such cost are not double counted.
	16. Replacement of term 'fall due'	The ED aims to replace the term "fall due" in the definitions of "short term" and "long term" employee benefits in order to solve potential inconsistencies between such definitions and the guidance on compensated absence in par. 8 In particular the new definitions are the following: - Short-term employee benefits are employee benefits (other than termination benefits) to which the employee becomes entitled within twelve months after the end of the period in which the employee renders the related service. - Other long-term employee benefits are employee benefits (other than post-employment benefits and termination benefits) to which the employee does not become entitled within twelve months after the end of the period in which the employee renders the related service. Guidance in par. 8 on short-term compensated absences has been amended accordingly.

		We support the ED proposals as it would solve classification problems for compensated absence due to employees that are not expected to occur within 12 months after the end of the period.
	17. Guidance on contingent liabilities	The ED plans to amend IAS 19 in order to solve an inconsistency between IAS 19 and IAS 37. Par. 32B of current IAS 19 states that IAS 37 requires recognition and disclosure of contingent liabilities. This isn't actually true as, according to IAS 37, contingent liabilities are disclosed (if they meet certain conditions) but are never recognized. To solve this inconsistency, the ED proposes to amend par 32B in order to delete references to recognition of contingent liabilities. We support the proposal.
IAS 20 Accounting for Government Grants and Disclosure of Government Assistance	18. Consistency of terminology with other IFRSs	The ED plans to amend some paragraphs of IAS 20 and IAS 41 in order to align the wording employed with the terminology employed by other IFRSs. We support the proposal as it doesn't

		change the meaning of the amended paragraphs.
	19. Government loans with a below-market rate of interest	The ED aims to align the accounting for loans from governments with a below market interest rate to IAS 39. Currently IAS 20 requires that no interest expenses should be accrued for loans with a nil interest rate This is, obviously, inconsistent with IAS 39 whose rules require the recognition of interest by employing an EIR which, for instruments at a below market interest rate, is equal to the market rate. In order to solve this inconsistency, the amendment clarifies that loans from governments with a below market interest rate should be recognized and measured in accordance with IAS 39. Accordingly interests should be recognized according to IAS 39. By doing so, also the amount of the government grants will be determined through IAS 39. Such amount should be presented in financial statements as a liability and expensed to income statements throughtout the life of the loan.

		We generally agree that the amendment would solve an inconsistency between IAS 20 and IAS 39 however we think it would be difficult for an entity whose debts are not quoted to determine an appropriate market rate for applying the accounting required.
IAS 23 Borrowing Costs	20. Components of borrowing costs	The ED plans to amend par. 6 of IAS 23 in order to align the definitions of borrowing costs to IAS 39. We note that the bullets amended refer to the same components that are considered for the determination of effective interest rate (EIR) according to IAS 39 (interests, amortization of discounts/premiums related to borrowings and amortisation of ancillary costs incurred in connection with the arrangement of borrowings where ancillary costs are interpreted as "transaction costs"). Consequently we support the proposal as it would achieve a greater consistency between IAS 23 and IAS 39.
IAS 27 Consolidated and Separate Financial Statements	21. Measurement of subsidiary held for sale in separate financial statements	According to IAS 27, investments in subsidiary, that are not classified as held for sale, must be accounted for in the separate financial statements of the

		parents, at cost or according to IAS 39. Investments in subsidiaries that are classified as held for sale should be accounted for according to IFRS 5. IFRS 5, however, excludes from its scope, assets that fall within the scope of IAS 39. Board decided to solve this perceived inconsistency by stating that in individual financial statements, investments accounted for according to IAS 39 should continue to be accounted for using IAS 39 even if they are classified as held for sale. IFRS 5 rules apply to investments accounted for using cost model only. This would determine a difference with the current model employed. According to current practice, investments in subsidiaries classified as held for sale are always accounted for according to IFRS 5 even if the IAS 39 accounting model was applied. According to the amendment such investments should continue to be accounted for under IAS 39 rules.

		We support the proposed amendments. As investments measured according to IAS 39 in the individual/separate financial statements are already measured at fair value, we don’t see the need to apply the measurement criteria required by IFRS 5 to them.
IAS 28 Investments in Associates	22. Required disclosures when investments in associates are accounted for at fair value through profit or loss	The ED aims to clarify the relationship between IAS 28 and IFRS 7/IAS 32 on the disclosure requirement for investments in associates classified as fair value through profit or loss. In particular, the ED clarifies that when an investment in a subsidiary is classified at fair value through profit and loss, disclosure included in par. 37f applies. (IAS 28, par. 37f: “*Nature and extent of any significant restrictions on the ability of the associates to transfer funds to the investor in the form of cash dividend or repayment of loans or advances*”). We support the ED proposals.
	23. Impairment of investment in associate	The ED aims to clarify that impairment on investment in associates should not be split between the “goodwill component” and “other assets” component of the amount resulting from the application of

		the equity method. Accordingly if the recoverable amount increases after an impairment loss has been recognized, the reversal can be wholly recognized. We support the clarification as it would avoid the burden to split up the impairment losses between goodwill component and other assets component.
IAS 29 Financial Reporting in Hyperinflationary Economies	24. Consistency of terminology with other IFRSs	We don't have comments.
IAS 31 Interests in Joint Ventures	25. Required disclosures when interests in jointly controlled entities are accounted for at fair value through profit or loss	The ED aims to clarify the relationship between IAS 31 and IFRS 7/IAS 32 on the disclosure requirement for investments in joint ventures classified as fair value through profit or loss. In particular, the ED clarifies that when an investment in a joint venture is classified at fair value through profit and loss, disclosure included in pars. 55 and 56 of IAS 31. applies. We support the proposal as it focuses the disclosure actually required for joint ventures classified as at fair value

		through profit or loss.
IAS 34 Interim Financial Reporting	26. Earnings per share disclosures in interim financial reports	The ED clarifies that in interim financial reports disclosure of earning per shares are required only if the entity falls within the scope of IAS 33. We support the proposal; we question if there is the need to specify that Earnings per share (EPS) disclosure has to be provided in accordance with IAS 33 as the employment of the same accounting policies as annual is a basic principle of IAS 34.
IAS 36 Impairment of Assets	27. Disclosure of estimates used to determine recoverable amount	According to IAS 36, the recoverable amount of a CGU or of an intangible asset with indefinite useful life is the higher of value in use and fair value less costs to sell. When recoverable amount is equal to value in use, IAS 36 requires a disclosure that is quite different from the one requested when recoverable amount is equal to fair value less cost to sell. This applies even when fair value less cost to sell is determined using valuation techniques that are broadly the same as the techniques employed for determining value in use.

		The ED aims to solve this inconsistency by requiring the same disclosure of value in use when fair value less cost to sell is determined through discounted cash flow projections. We support the proposals as it would determine disclosure of useful information when the recoverable amount is determined through subjective evaluations.
IAS 38 Intangible Assets	28. Advertising and promotional activities	According to IAS 38, advertising, promotional, training, relocation and start-up expenses have to be recognized in income statements when incurred. The ED tries to clarify the meaning of "incurred". In particular in case of the supply of goods, expenses have to be recognized in income statements when the entity has access to the goods. In case of services, expenses have to be recognized in an income statement when the entity receives the services. We support the proposed amendments as they clarify that such expenses should not be recognized when paid but when associated goods and services are received.

	29. Unit of production method of amortisation	The ED aims to clarify that unit of production method of amortization is allowed also for amortization of intangible assets. Current IAS 38 states that "There is rarely, if ever, persuasive evidence to support an amortization method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight line method". This sentence has been interpreted as forbidding the employment of such method for amortizing intangible assets. Accordingly the ED plans to delete the reported sentence. We support the proposal as the unit of production method of amortization will be employed for amortising intangible assets, for example, arising from service concession arrangements.
IAS 39 Financial Instruments: Recognition and Measurement	30. Definition of a derivative	The ED aims to amend the definition of derivatives in order to clarify the interaction between IAS 39 and IFRS 4. According to the current definition of derivatives, a contract whose value changes in response to changes in non-

		financial variables specific to a party of the contract isn't a derivative. The ED eliminates such exclusion. Accordingly a contract whose value changes in response to changes in non-financial variables is a derivative that must be accounted for under IAS 39 unless it falls within the scope of IFRS 4. It must be noted that the definition of insurance contracts relies on a definition of financial risks that mirrors the definition of derivatives and that includes "non financial variable not specific to a party to the contract". Accordingly this amendment should not significantly increase the number of contracts that have to be classified as derivatives. In theory, the amendment would determine an increase in instruments classified as derivatives (i.e. contracts whose value changes in response to a change in a non-financial variable specific to a party of a contract that, however, do not meet the definition of insurance contract); however we would like to assess examples of such contracts. For the above mentioned reasons we

		support the proposal.
	31. Reclassification of financial instruments into or out of the classification of at fair value through profit or loss	The ED clarifies that designation/de-designation of a derivatives as hedging instruments doesn't constitute reclassification for the purpose of IAS 39 Even if we are not sure that such a clarification is really needed we support it.
	32. Designating and documenting hedges at the segment level	Paragraph 73 states that only derivatives external to the reporting entity qualify as hedging derivatives. According to the guidance provided by such paragraph this applies also when a reporting entity is a segment. IASB has found such guidance inconsistent with the new IFRS 8 under which segments and amounts reported should be determined according to the information reported to top management. In order to solve this inconsistency the ED proposes to delete reference to segments in par. 73. As IFRS 8 adopts a "through the eyes of the management" approach, the hedge accounting approach employed for segment reporting could differ and is independent from the one required by IAS 39.

		Accordingly we support the proposal.
	33. Applicable effective interest rate on cessation of fair value hedge accounting	IAS 39 requires that when fair value hedge accounting of an instrument measured at amortised cost ceases, the entity has to recalculate the EIR in order to amortise any revaluation recorded following the application of hedge accounting The ED clarifies that the revised effective interest rate has to be employed also for re-measuring the item when the entity revises its estimates of payments and receipts. We support the ED's proposal.
	34. Treating loan prepayment penalties as closely related embedded derivatives	The ED clarifies that prepayment options for which the exercise price compensates the lender for loss of interest by reducing the economic loss from reinvestment risk is closely related to the host debt contract. We agree with the proposal, however we think that such rule should apply not only when the exercise price compensates the lender for loss of interest but also when the prepayment option compensates the

		holder for other losses (such as losses due to the need to close associated hedging derivatives) as long as par. AG33a) doesn't apply.
IAS 40 Investment property	35. Property under construction or development for future use as investment property	The ED aims to include in the scope of IAS 40 property that is being constructed or developed for future use as investment property. Accordingly such property could be measured at fair value with changes recognized in profit or loss. According to current rules property under construction or development are accounted for according to IAS 16 in order to avoid the application of the fair value criteria We support EFRAG's reply as it's our understanding that current IFRS rules do not allow revaluation of property under construction. For instance IAS 40 B16 – B20 clarified that investment properties under construction or development are excluded from the scope of IAS 40 and included in the scope of IAS 16 in order to avoid measurement at fair value.
	36. Consistency of terminology with IAS 8	The ED propose to align the wording employed by IAS 40 when dealing with changes in accounting policies with the

		wording employed by IAS 8. We support the proposal as it would ensure a greater consistency between accounting standards
	37. Investment property held under lease	The ED clarifies that when an entity applies the fair value model,the carrying amount of the investment property has to be determined considering also the lease liability. The current wording stated that fair value (and not carrying amount) has to be determined considering the lease liability We support the clarification proposed
IAS 41 Agriculture	38. Point of sale costs 39. Discount rate for fair value calculations 40. Additional biological transformation 41. Examples of agricultural produce and products Consequential amendment from IAS 20: Consistency of terminology with other . IFRSs	We don't have comments.