STAFF PAPER

September 2013

IASB Meeting

Project	**Annual Improvements project: 2010-2012 and 2011-2013 cycles**
Paper topic	Sweep issues

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Purpose of this paper

1. The objective of this paper is to address:

   (a) Matters related to a due process complaint on the amendment to IAS 40 *Investment Property*—Clarifying the interrelationship of IFRS 3 with IAS 40 when classifying property as investment property or owner-occupied property (included in the *Annual Improvements to IFRSs 2011–2013 Cycle*); and

   (b) Two sweep issues identified by interested parties during the fatal flaw review of the *Annual Improvements to IFRSs* (2010–2012 and 2011-2013 Cycles). These sweep issues relate to the following amendments:

      (i) the amendment to the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*—Meaning of effective IFRSs (included in the *Annual Improvements to IFRSs 2011–2013 Cycle*); and

      (ii) the amendment to the Basis for Conclusions on IFRS 13 *Fair Value Measurement*—Short-term receivables and payables (included in the *Annual Improvements to IFRSs 2010–2012 Cycle*).

Staff analysis

Issue 1: Due process complaint on the amendment to IAS 40

The amendment to IAS 40

2. The Exposure Draft *Annual Improvements to IFRSs 2011–2013 Cycle* includes a proposal for an amendment to IAS 40 that would clarify that:

   (a) judgement is needed to determine whether the acquisition of investment property is the acquisition of a single asset or of a group of assets, or is a business combination within the scope of IFRS 3; and

   (b) this judgement is not based on paragraphs 7-14 of IAS 40 but on the guidance in IFRS 3. The guidance in paragraphs 7-14 of IAS 40 relates only to the judgement needed to distinguish an investment property from an owner-occupied property.

3. At its meeting in June 2013, the IASB tentatively decided to finalise this amendment.

4. The *Annual Improvements to IFRSs 2011–2013 Cycle* is expected to be published in Q4 2013.

5. The proposed wording for this amendment is in Appendix A of this paper.

The due process complaint

6. The full complaint letter is in Appendix B of this paper. We reproduce below some paragraph of this letter to explain the issue.

> As part of our response to the proposed amendments to IAS 40 *Investment Property* we explained:
>
> "*However, while the amendment is expected to be a very narrow change to the current IFRSs, it nevertheless illustrates the need to consider more globally the consequences of the distinction between assets and businesses and whether guidance to distinguish assets from businesses is needed as part of the post implementation review of IFRS 3.*
>
> *We do not believe that the proposed change to IAS 40 answers this concern.*"
>
> In summary, while we understood what the IASB was aiming at, we did not believe that the proposal was useful in the manner it was drafted.

> When reading the Staff's May 2013 IFRS Interpretations Committee ("IFRIC") Agenda paper 11D, we were therefore surprised to note in paragraph 16 of that paper that the Staff interpreted our comments as agreement with the proposed changes to IAS 40.
>
> We appreciate of course that opening paragraphs which generically welcome the IASB or IFRIC doing something could be misunderstood to support the proposal, but so far expected the Staff to be able to differentiate between pleasantry opening statements and actual support of a proposal,
>
> We are deeply concerned about such possible misinterpretations of comment letters by the Staff in such a area at the heart of the due process, as (a) the IASB and IFRIC members significantly rely on the analysis performed by the Staff and (b) constituents are usually not and should not be required reviewing every time the Staff's paper for appropriate reflection of their thoughts and concerns

7. We reproduce below the respondent's comment from its comment letter[1] on the proposed annual improvement:

> BUSINESSEUROPE welcomes the clarification that judgement is required to determine whether the property acquired meets the definition of an asset, group of assets or business as defined in IFRS 3 *Business Combinations* and that reference should be made to IFRS 3 for such determination.
>
> However, while the amendment is expected to be a very narrow change to current IFRSs, it nevertheless illustrates the need to consider more globally the consequences of the distinction between assets and businesses and whether guidance to distinguish assets from businesses is needed as part of the post implementation review of IFRS 3.
>
> We do not believe that the proposed change to IAS 40 answers this concern.
>
> Assessing the consequences more globally would also ensure a consistent approach at a time several projects are currently ongoing at the IASB namely:
>
> - Sales or contributions of assets between an investor and its associate/ joint venture (Proposed amendments to IFRS 10 and IAS 28); and
> - Acquisition of an interest in a joint operation (Proposed amendments to IFRS 11).

[1] For further details see the full comment letter: http://eifrs.ifrs.org/eifrs/comment_letters/13/13_724_JrmeChauvinBUSINESSEUROPE_0_l0218annualimprovements.pdf

8. In paragraph 16 of Staff Paper 11D (May 2013 IFRS Interpretations Committee meeting) we summarised the respondent's comment (and other similar comments) as follows:

> Some respondents agreed with the proposed amendment, but believe that as part of the post-implementation review of IFRS 3 the IASB should:
>
> (a) consider the consequences of the distinction between acquisition of assets and businesses (EFRAG and BusinessEurope); and
>
> (b) assess the need for expanded specific guidance in IFRS to distinguish when an investment property should be considered as a business or not (BusinessEurope, Repsol and BDO).

Question for the IASB

Having reviewed the original comment letter from BusinessEurope again, we are now asking the IASB: if we had written paragraph 16 of Staff Paper 11D as follows, would the IASB have made a different decision?

> Some respondents ~~agreed with the proposed amendment, but~~ believe that as part of the post-implementation review of IFRS 3 the IASB should:
>
> (a) consider the consequences of the distinction between acquisition of assets and businesses (EFRAG and BusinessEurope); and
>
> (b) assess the need for expanded specific guidance in IFRS to distinguish when an investment property should be considered as a business or not (BusinessEurope, Repsol and BDO).

Issue 2: Fatal flaw in the amendment to the Basis for Conclusions on IFRS 1

The amendment to the Basis for Conclusions on IFRS 1

9. The Exposure Draft *Annual Improvements to IFRSs 2011–2013 Cycle* includes a proposal for an amendment to the Basis for Conclusions of IFRS 1 to clarify that an entity has the choice between applying an old Standard that is still effective or applying a new one that is not yet mandatory, but for which early application is permitted. If a new Standard is applied early in the entity's first IFRS financial

statements, that entity is required to apply the same version of that Standard throughout the periods covered by the entity's first IFRS financial statements, unless IFRS 1 grants specific exemptions or exceptions.

10. The IASB decided that IFRS 1 was clear but because of the conflicting language in the Basis for Conclusions it proposed an amendment to the Basis for Conclusions of IFRS 1.

11. At its meeting in June 2013, the IASB tentatively decided to finalise this amendment.

12. The *Annual Improvements to IFRSs 2011–2013 Cycle* is expected to be published in Q4 2013.

13. The proposed wording for this amendment is in Appendix A of this paper.

The potential fatal flaw

14. We distributed to a selected group of reviewers the editorial review drafts of the:

    (a) Annual Improvements to IFRSs 2010–2012 Cycle; and

    (b) Annual Improvements to IFRSs 2011–2013 Cycle.

15. One reviewer thinks that there is a fatal flaw in the amendment to the Basis for Conclusions on IFRS 1 because it explains the authoritative requirements rather than the IASB's rationale for determining the requirements in the Standard. The reviewer thinks that non-authoritative material is being used to provide guidance on how to apply the Standard.

16. The reviewer notes that according to the *Due Process Handbook*, a Basis for Conclusions explains the rationale the IASB had for the decisions it reached in developing or changing an IFRS at that time. Thus, the reviewer questions whether this amendment that explains the requirements in IFRS 1 in the Basis for Conclusions is consistent with the *Due Process Handbook*.

17. The reviewer also thinks that:

    (a) if the amendment is not revised, the amendment will not resolve the conflict in practice, because not all entities will read the Basis for Conclusions and the Standard together;

(b) in many jurisdictions, entities may have free access only to the Standard, and so such entities would not benefit from guidance in the Basis for Conclusions that clarifies IFRS requirements; and

(c) if the guidance proposed in paragraph BC11A is considered necessary, then it should be incorporated into the Standard.

Staff view on Issue 2

18. In our view, paragraphs 7 and 8 of IFRS 1 are sufficiently clear. In particular:

(a) paragraph 8 states that (emphasis added):

> …An entity **may** apply a new IFRS that is not yet mandatory if that IFRS permits early application…; and

(b) the example in paragraph 8 states that:

> … If a new IFRS is not yet mandatory but permits early application, entity A is permitted, but not required, to apply that IFRS in its first IFRS financial statements.

19. The issue arose because paragraph BC11 of IFRS 1 states (emphasis added):

> Paragraphs 7–9 of the IFRS require a first-time adopter to apply the current version of IFRSs, **without considering superseded or amended versions**. This:
>
> (a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;
>
> (b) gives users comparative information prepared using later versions of IFRSs that the Board regards as superior to superseded versions; and
>
> (c) avoids unnecessary costs.

This paragraph would imply that the entity *should* use the new version of the Standard, and goes on to explain why this is recommended. The submitter of the original issue, therefore, requested clarification of this discrepancy between paragraphs 7-8 of IFRS 1 and BC11 of IFRS 1.

20. In our view:

(a) we cannot address this perceived discrepancy by amending the Standard, because the Standard is already clear;

(b) we cannot amend or delete paragraph BC11 (which is the source of the issue), because it summarises the IASB's original considerations in reaching the conclusions in IFRS 1; and

(c) consequently the only way to address this issue is:

(i) to add a footnote to paragraph BC11 to clarify that BC11 (not being authoritative) does not require the use of a more recent version of an IFRS; and

(ii) add a paragraph (ie paragraph BC11A) to highlight that the authoritative guidance (in paragraphs 7 and 8 of IFRS 1) permits an entity to use either the currently mandatory IFRS or the new IFRS that is not yet mandatory, if that IFRS permits early application. The proposed wording as agreed by the IASB in June 2013is in Appendix A of this paper.

21. We acknowledge that the proposed paragraph BC11A could be included in the Implementation Guidance to IFRS 1, however we do not think this would address the concern that was originally raised. We continue to think that in order to address the contradictory wording between the Standard and the Basis for Conclusions, it is necessary to make the amendment in the Basis for Conclusions.

Issue 3: Fatal flaw in the amendment to the Basis for Conclusions on IFRS 13

The amendment to the Basis for Conclusions on IFRS 13

22. The Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle* includes a proposal for an amendment to the Basis for Conclusions of IFRS 13 to explain the deletion of B5.4.12 of IFRS 9 *Financial Instruments* and paragraph AG79 of IAS 39 *Financial Instruments: Recognition and Measurement*. In particular, the IASB proposed to clarify that, when making those amendments to IFRS 9 and IAS 39 (when it issued IFRS 13), it did not intend to remove the ability of an entity to measure short-term receivables and payables with no stated interest rate at invoice amounts

without discounting, when the effect of not discounting is immaterial. Instead, the IASB deleted those paragraphs in IFRS 9 and IAS 39 because IFRS 13 contains guidance for using present value techniques to measure fair value and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* addresses materiality in applying accounting policies.

23. At its meeting in February 2013, the IASB tentatively decided to finalise this amendment.

24. The *Annual Improvements to IFRSs 2010–2012 Cycle* is expected to be published in Q4 2013.

25. The proposed wording for this amendment is in Appendix A of this paper.

The potential fatal flaw

26. Similarly to Issue 2, the same reviewer thinks that there is a fatal flaw in the amendment to the Basis for Conclusions on IFRS 13, because changes to the Basis for Conclusions should be restricted to describing why and how Standards are developed and not include any guidance for applying them.

27. The reviewer suggests including an explicit statement in IFRS 13 to confirm that short-term receivables and payables need not be discounted when the effect of discounting is not significant or material.

Staff view on Issue 3

28. In our view, this amendment is not providing guidance on how to apply a Standard; it is only explaining the IASB's thinking, which is: paragraph 8 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* already permits entities not to apply accounting policies set out in accordance with IFRSs when the effect of applying them is immaterial. Consequently, it is not necessary to include a specific provision in the Standard to specify that short-term receivables and payables need not be discounted when the effect of discounting is immaterial.

Staff recommendation

29. On the basis of the analysis above, we recommend that the IASB should confirm the finalisation of the following amendments:

    (a) the amendment to IAS 40 *Investment Property*—Clarifying the interrelationship of IFRS 3 with IAS 40 when classifying property as investment property or owner-occupied property;

    (b) the amendment to the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*—Meaning of effective IFRSs; and

    (c) the amendment to the Basis for Conclusions on IFRS 13 *Fair Value Measurement*—Short-term receivables and payables.

Question for the IASB
Does the IASB agree with the staff recommendation to confirm the finalisation of the amendments to IAS 40, IFRS 1 and IFRS 13?

Appendix A—The amendments

A1. In this Appendix, changes are marked-up based on the text included in the (red) Bound Volume as of 1 January 2013. New text is underlined and deleted text is ~~struck through~~.

Amendment to IAS 40 *Investment Property*[2]

Before paragraph 6, a heading is added. Paragraph 14A is added. After paragraph 84 a heading and paragraph 84A are added. Paragraph 85D is added. Paragraphs 6 and 14 have been included for ease of reference but are not proposed for amendment.

Classification of property as investment property or owner-occupied property

6 **A *property interest* that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, the property would otherwise meet the definition of an investment property and the lessee uses the fair value model set out in paragraphs 33–55 for the asset recognised. This classification alternative is available on a property-by-property basis. However, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model. When this classification alternative is selected, any interest so classified is included in the disclosures required by paragraphs 74–78.**

…

14 Judgement is needed to determine whether a property qualifies as investment property. An entity develops criteria so that it can exercise that judgement consistently in accordance with the definition of investment property and with the related guidance in paragraphs 7–13. Paragraph 75(c) requires an entity to disclose these criteria when classification is difficult.

14A Judgement is also needed to determine whether the acquisition of investment property is the acquisition of an asset or a group of assets or a business combination within the scope of IFRS 3 *Business Combinations*. Reference should be made to IFRS 3 to determine whether it is a business combination. The discussion in paragraphs 7– 14 of this Standard relates to whether or not property is owner-occupied property or investment property and not to determine whether or not the acquisition of property is a business combination as defined in IFRS 3. Determining whether a specific transaction meets the definition of both a business combination as defined in IFRS 3 and includes an investment property as defined in this Standard requires the separate application of both Standards.

...

[2] This is the wording proposed at the June 2013 IASB meeting; see Agenda Paper 12B.

Transitional provisions

Business Combinations

84A *Annual Improvements Cycle 2011– 2013* **issued in [date] added paragraph 14A and a heading before paragraph 6. An entity shall apply that amendment prospectively for acquisitions of investment property from the beginning of the first period for which it adopts that amendment. Consequently, amounts recognised for acquisitions of investment property in prior periods shall not be adjusted. However, retrospective application of that amendment is permitted if and only if information needed to apply the amendment retrospectively is available to the entity.**

Effective date

…

85D *Annual Improvements Cycle 2011– 2013* issued in [date] added paragraphs 14A and 84A and a heading before paragraph 6. An entity shall apply those amendments for annual periods beginning on or after 1 July 2014. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*[3]

The IASB proposes to amend the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*, which is not part of the Standard, by adding a footnote to paragraph BC11 and adding paragraph BC11A. New text is underlined and deleted text is struck through.

BC11 Paragraphs 7–9 of the IFRS require a first-time adopter to apply the current version of IFRSs, without considering superseded or amended versions[4]. This:

(a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;

(b) gives users comparative information that was prepared using later versions of IFRSs that the IASB regards as superior to superseded versions; and

(c) avoids unnecessary costs.

BC11A Paragraph 7 requires an entity to use the IFRSs that are effective at the end of its first IFRS reporting period. Paragraph 8 allows a first-time adopter to apply a new IFRS that is not yet mandatory if that IFRS

[3] This is the wording proposed at the June 2013 IASB meeting, see Agenda Paper 12B.

[4] This paragraph does not require an entity to use a more recent version of an IFRS. It only explains the advantages of applying a more recent version of an IFRS. See paragraph BC11A for further details.

permits early application. Notwithstanding the advantages set out in paragraph BC11 of applying a more recent version of an IFRS, paragraphs 7 and 8 permit an entity to use either the currently mandatory IFRS or the new IFRS that is not yet mandatory, if that IFRS permits early application. Paragraph 7 requires an entity to apply the same version of the IFRS throughout the periods covered by the entity's first IFRS financial statements. Consequently, if a first-time adopter chooses to early apply a new IFRS, that new IFRS will be applied throughout the periods presented in its first IFRS financial statements, unless IFRS 1
provides an exemption or an exception that permits or requires otherwise.

Amendment to Basis for Conclusions on IFRS 13 *Fair Value Measurement*[5]

Paragraph BC138A and the heading above it are added.

Short-term receivables and payables

BC138A After issuing IFRS 13, the IASB was made aware that an amendment to IFRS 9 and IAS 39, which resulted in the deletion of paragraphs B5.4.12 and AG79 respectively, might be perceived as removing the ability to measure short-term receivables and payables with no stated interest rate at invoice amounts without discounting, when the effect of not discounting is immaterial. The IASB disagrees with that perception noting that paragraph 8 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* already permits entities not to apply accounting policies set out in accordance with IFRSs when the effect of applying them is immaterial.

[5] This is the wording proposed at the February 2013 IASB meeting, see Agenda Paper 8D.

Appendix B—The due process compliant letter

BUSINESSEUROPE

Due Process Oversight Committee
IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

9 July 2013

Dear Sirs,

Re: Proposal to amend IAS 40 – comment letter analysis

We are writing to you to express our concerns about the comment letter analysis performed by the ISAB Staff ("the Staff'), following an observation in connection with the proposal to amend IAS 40 as part of the current annual improvement cycle (2011 – 2013).

In November 2012, the IASB published the Exposure Draft ED/2012/2 Annual Improvements to IFRSs 2011-2013 Cycle in November 2012. BUSINESSEUROPE responded to the exposure draft on 18 February 2013.

As part of our response to the proposed amendments to IAS 40 *Investment Property* we explained:

"However, while the amendment is expected to be a *very narrow change to the current IFRSs, it nevertheless illustrates the need to consider more globally the consequences of the distinction between assets and businesses and whether guidance to distinguish assets from businesses is needed as part of the post implementation review of /FRS* 3.

We do not believe that the proposed change to /AS 40 answers this concern."

In summary, while we understood what the IASB was aiming at, we did not believe that the proposal was useful in the manner it was drafted.

When reading the Staffs May 2013 IFRS Interpretation Committee ("IFRIC") Agenda paper 11D, we were therefore surprised to note in paragraph 16 of that paper that the Staff interpreted our comments as agreement with the proposed changes to IAS 40.

We appreciate of course that opening paragraphs which generically welcome the IASB or IFRIC doing something could be misunderstood to support the proposal, but so far expected the Staff to be able to differentiate between pleasantry opening statements and actual support of a proposal.

We are deeply concerned about such possible misinterpretations of comment letters by the Staff in such a area at the heart of the due process, as (a) the IASB and IFRIC

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members significantly rely on the analysis performed by the Staff and (b) constituents are usually not and should not be required reviewing every time the Staff's paper for appropriate reflection of their thoughts and concerns.

In fact in connection with the recently issued Amendment to IAS 36 *Recoverable Amount Disclosure* we noted that the Staff did not even include a – from our perspective – important concern in their analysis and we contacted the IASB and EFRAG in connection with that in our letter dated 11 June 2013, which we have attached in appendix for your reference.

We would therefore appreciate if you could elaborate on the process put in place that ensures the quality of the Staff analysis with respect to the appropriate reflection of constituents inputs and what review and quality assurance steps the Due Process Oversight Committee is performing or taking in this respect.

We would also like to link this with our concerns raised during our earlier correspondence with you, namely our letter to you dated 11 June 2012 and our comments sent in connection with the due process handbook, dated 11 September 2012, particularly with respect to transparency in connection with meetings the Staff has with constituents and the feedback to the IASB and / or IFRIC.

We remain at your disposal should you wish to discuss this subject further.

Yours sincerely,

Jerome P. Chauvin
Director
Legal Affairs Department
Internal Market Department