European Financial Reporting Advisory Group

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1049 Brussels

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Dear Mr. Faull

Adoption of the Improvements to IFRS (Issued in May 2010)

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the adoption of the *Improvements to IFRS* issued in May 2010 (the Amendments).

The IASB has adopted an annual process to deal with non-urgent albeit necessary amendments to IFRS (the annual improvements process). Issues dealt with in this process arise from matters raised by the International Financial Reporting Interpretations Committee (IFRIC) and suggestions from IASB staff or practitioners, and focus on areas of inconsistency in IFRSs or where clarification of wording is required. There are 11 individual amendments to 7 standards in the *IFRS Annual Improvements* publication issued in May 2010, covering a variety of subjects. The effective date for each amendment is included within each area of affected IFRS.

EFRAG has carried out an evaluation of the Amendments. As part of that process, EFRAG issued an initial evaluation of the Amendments against the EU endorsement criteria for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports the Amendments and has concluded that they meet the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, in that:

- they are not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

- they meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Amendments and, accordingly, EFRAG recommends their adoption. EFRAG's reasoning is explained in the attached 'Appendix 1 – Basis for Conclusions'.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Francoise Flores
EFRAG, Chairman

APPENDIX 1
EFRAG'S TECHNICAL ASSESSMENT OF THE AMENDMENTS AGAINST THE ENDORSEMENT CRITERIA

Basis for Conclusions

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendments.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

Introduction

1 When evaluating the merits of the Amendments, EFRAG considered the following key questions:

   (a) Are the requirements of the Amendments consistent with the IASB's Framework for the Preparation and Presentation of Financial Statements ('the Framework')?

   (b) Would the Amendments' implementation result in an improvement in accounting?

   (c) EFRAG has considered whether the Amendments meets the requirements of the European Parliament and of the Council on the application of International accounting standards, in other words that the Amendments:

      (i) are not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and in Article 2(3) of Council Directive 78/660/EEC; and

      (ii) meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

2 EFRAG has also considered whether it is in the European interest to adopt the Amendments.

Are the requirements of the Amendments consistent with the IASB's Framework?

3 EFRAG considered whether the requirements in the Amendments are consistent with the IASB's Framework. When EFRAG considered whether existing IFRSs should be endorsed, it considered whether their accounting treatments were consistent with the Framework. As the Amendments involve providing clarification and additional guidance on some accounting aspects of those existing IFRSs —and as a result do not introduce fundamental changes to existing IFRS literature— EFRAG concluded that the Amendments are consistent with the provisions in the Framework.

Would the Amendments' implementation result in an improvement in accounting?

4 EFRAG notes that, of the eleven Amendments in the standard, the eight Amendments listed below are clarifications or corrections of existing IFRS or are Amendments that are consequences from changes made to IFRSs previously:

- IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Accounting policy changes in the year of adoption;
- IFRS 3 *Business Combinations* – Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS;
- IFRS 3 *Business Combinations* – Measuring non-controlling interests;
- IFRS 3 *Business Combinations* – Un-replaced and voluntarily replaced share-based payment awards;
- IFRS 7 *Financial Instruments: Disclosures* – Clarification of disclosures;
- IAS 1 *Presentation of Financial Statements* – Clarification of statement of changes in equity;
- IAS 27 *Consolidated and Separate Financial Statements* – Transition requirements for consequential amendments of IAS 27 to IAS 21, IAS 28 and IAS 31;
- IFRIC 13 *Customer Loyalty Programmes* – Fair value of award credits.

5 In EFRAG's view, the above Amendments are straightforward and not controversial; by clarifying or correcting existing IFRS in some – albeit small way – they make standards easier to implement consistently, without raising any new concerns. Those Amendments are not discussed specifically in this appendix.

6 The following amendments (two amendments to IFRS 1 and one amendment to IAS 34) involve changes to the existing requirements or additional guidance on the implementation of those requirements:

- IFRS 1 *First-time Adoption of IFRSs* – Revaluation basis as deemed cost and Use of deemed cost for operations subject to rate regulation; and

- IAS 34 *Interim Financial Reporting* – Significant events and transactions.

7 We consider the amendment to IAS 34 to be straightforward and not controversial. Therefore, we do not discuss that amendment specifically in this appendix.

IFRS 1 *First-time Adoption of IFRSs –- Revaluation basis as deemed cost and Use of deemed cost for operations subject to rate regulation*

8 The amendment to IFRS 1 – *Revaluation basis as deemed cost* does not significantly change paragraph D8, but rather increases its scope. Hence it is unlikely that it will have a significant impact on understandability, relevance, reliability and comparability of financial statements. EFRAG has therefore not commented specifically on this amendment as the exemption already existing IFRS 1 is not altered by this amendment.

9 EFRAG has commented on the amendment to IFRS 1 – *Use of deemed cost for operations subject to rate regulation* here below because we believe the amendment has an impact on comparability, relevance, reliability and understandability.

<u>Comparability</u>

10 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that dissimilar items and events should be accounted for differently.

11 As with any introduction of a deemed cost measurement base, comparability is impaired between first-time adopters and entities that already apply existing IFRS. This is because rate regulated entities can apply the exemption to use deemed cost which may not include items that would be allowed to be capitalised under existing IFRS.

12 Having said that, disclosing the basis of calculations under previous GAAP will assist users to reconcile the differences between that GAAP and IFRS which will reduce to some extent the incomparability.

13 The amendment will allow for easier adoption of IFRS and accordingly more rate regulated entities will apply IFRS so that over-time financial statements become more comparable.

14 There is a cost-benefit trade off in terms of comparability; however, EFRAG thinks the benefits of applying the amendment will exceed the costs of reduced comparability.

15 As a result, EFRAG's assessment is that the amendment meets the comparability criterion.

<u>Relevance</u>

16 According to the Framework, information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

17 EFRAG's assessment about the amendments' relevance is very similar to its assessment of comparability; there might be a short-term deterioration in relevance. However there will be an overall improvement in the relevance of the information provided. For that reason, EFRAG's overall assessment is that the amendment meets the relevance criterion.

<u>Reliability</u>

18 EFRAG also considered the reliability of the information that will be provided by applying the Amendment. The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

19 The amendment allows an entity to use previous GAAP carrying amounts in its opening IFRS balance sheet. As this does not require any new estimates to be made, EFRAG believes that this does not give rise to reliability concerns.

<u>Understandability</u>

20 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence. Although there are a number of aspects to the notion of 'understandability', EFRAG believes that most aspects are covered by the discussion above about relevance, reliability and comparability (because, for example, information that represents something as similar when it is in fact dissimilar is not comparable, and that lack of comparability will mean it is also not understandable). As a result, EFRAG believes that the main additional issue it needs to consider in assessing whether the information resulting from the application of the amendment is understandable is whether that information will be unduly complex.

21 EFRAG's view is that the amendment does not introduce new complexities into the financial statements.

<u>True and fair view</u>

22 For the reasons set out above, EFRAG does not believe that the amendment is inconsistent with the true and fair view requirement.

Does the accounting that results from the application of the Amendments meet the criteria for EU endorsement?

23 As already mentioned, EFRAG has previously concluded that the various IFRSs affected by the Amendments meet the endorsement criteria. Furthermore, as explained above, EFRAG believes that the Amendments are consistent with the Framework, and its assessment is that the Amendments are likely either to improve the financial information provided or have no effect on that information. In particular, EFRAG has concluded that the Amendments meet the criteria of understandability, relevance, reliability and comparability required of the financial

information needed for making economic decisions and assessing the stewardship of management.

24 EFRAG also concluded that there was no reason to believe that the information resulting from the application of the Amendments would be contrary to the true and fair view principle or that implementation of the Amendments in the EU would be contrary to the European interest.

Conclusion

25 EFRAG has concluded that the Amendments satisfy the criteria for endorsement in the EU and that it should recommend that the Amendments be endorsed for use in the EU.