DRAFT COMMENT LETTER

Comments should be sent to commentletter@efrag.org by 1 November 2009

XX 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*. 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. To summarise, we agree in principle with all the proposals in the ED, although we sometimes raise some detailed issues or see a need for some rewording or for an additional amendment to make the issue clearer.

The only exception to this is that we do not agree with all the changes being proposed to IAS 27 *Consolidated and Separate Financial Statements* (ie Issue 10). The proposed amendments to IAS 27 do several things, and the part of the proposed amendment that we disagree with is the proposal that the words "in accordance with IAS 39" in paragraph 38(b) of IAS 27 should be replaced with "at fair value through profit or loss".

This proposal is not explained in the Basis for Conclusions, although EFRAG understands that the IASB considers the amendment to be a clarification of what was always the intention. However, it is our understanding that the existing wording of paragraph 38(b) of IAS 27 is widely interpreted by those who apply IFRS 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 OCI. The proposal will as a result have the effect of narrowing down the accounting choice available under existing IFRS. We are not convinced it is appropriate to restrict the way in which an entity applies IAS 39 to such investments.

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

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix
ERAG's detailed comments on the amendments proposed

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

Notes for EFRAG's constituents

1. *Paragraph 27 of IFRS 1* First-time Adoption of IFRSs *states that "IAS 8 does not deal with changes in accounting policies that occur when an entity first adopts IFRSs. Therefore, IAS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first IFRS financial statements."*

2. *The IASB has been asked to clarify:*

   (a) *whether a first-time adopter is exempt from all the requirements of IAS 8 for the interim and annual periods presented in its first IFRS financial statements;*

   (b) *if and to the extent that IAS 8 does not apply, what, if any, requirements apply when an entity changes its accounting policies between the first interim financial statements it presents in accordance with IFRSs and its first annual financial statements; and*

   (c) *whether an entity is able under IFRS to change the way it is applying the exemptions and other reliefs available under IFRS 1 in its first annual IFRS financial statements, compared to how it applied them in preparing interim financial statements and, if it is able to change them, what if any requirements apply to those changes in accounting policies.*

3. *The IASB observed that IFRS 1 deals with the transition from local GAAP to IFRS, and IAS 8 with changes in accounting policies thereafter. It also observed that an entity completes the transition from local GAAP to IFRS when it has finalised its first IFRS annual financial statements. Thus, a first-time adopter is exempt from all the requirements of IAS 8 for the interim and annual periods presented in its first IFRS financial statements and, if that entity wishes to change the way it is applying the exemptions and other reliefs available under IFRS 1 in its first annual IFRS financial statements compared to how it applied them in preparing interim financial statements, it is free to do so; and such a change will be governed by the requirements of IFRS 1.*

4. *The IASB further noted that IFRS 1 requires an entity to explain how transition from a different accounting framework to IFRSs affected its reported financial position, results and cash flows. In particular, IFRS 1 requires reconciliations of profit or loss and of equity reported under previous GAAP to those under IFRSs at both the date of transition to IFRSs and the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP. If an entity presents interim financial reports in accordance with IAS 34, its first interim financial report for part of the period covered by its first IFRS financial statements shall include those reconciliations.*

5 *The IASB concluded that, to comply with IFRS 1's requirement to explain its transition to IFRS, an entity should be required to explain any changes in its accounting policies or IFRS 1 exemptions it applied between its first IFRS interim financial report and its first IFRS annual financial statements. The IASB decided that the most useful information it could require was updated reconciliations between previous GAAP and IFRSs.*

6 *The IASB is therefore proposing to amend IFRS 1 to clarify the position.*

EFRAG's comments

7 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

Notes for EFRAG's constituents

8 *Some entities might have established a deemed cost in accordance with the accounting requirements they were following at the time for some or all of their assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatisation or initial public offering (IPO). Existing paragraph D8 of IFRS 1 permits a first-time adopter to use such an event-triggered revaluation basis as 'deemed cost' under IFRSs.*

9 *The IASB received a request to reconsider the scope of the exemption in paragraph D8. In particular, the existing wording suggests that the exemption applied to events such as a privatisation or IPO that occurs before the date of transition to IFRSs, and the IASB was asked to consider whether the exemption should also be available for similar events occurring after the date of transition to IFRSs but during the periods covered by the first-time adopter's first IFRS financial statements. The IASB concluded that the reasons it granted an exemption for such events when they arise prior to the date of transition apply equally when the event occurs during the period covered by the first IFRS financial statements. It is therefore proposing to amend paragraph D8 to reflect that conclusion.*

10 *The IASB decided to require an entity to establish the deemed cost on the date of that measurement and, for the periods prior to that date, present historical costs or other amounts already permitted by IFRS 1. Because it was broadening an existing exemption to a first-time adopter for an event-driven revaluation that occurred during its first set of IFRS financial statements, the IASB decided to permit retrospective application of the proposed amendment rather than mandate it.*

EFRAG's comments

11 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.

Notes for EFRAG's constituents

12 When the IASB issued the revised IFRS 3 Business Combinations *it made some amendments to other IFRSs to delete the scope exemption in those IFRSs in respect to the accounting for contingent consideration. The effect is that in a business combination, all contingent consideration is accounted for in accordance with the revised IFRS 3. However, the IASB has been advised that it is not clear whether contingent consideration for business combinations that arose prior to the adoption of the revised IFRS 3 should also be accounted for under the revised standard or whether it should be accounted for under the 'old' IFRS 3. The IASB was asked to clarify this issue.*

13 The IASB has noted that paragraph 64 of revised IFRS 3 states that the revised standard should be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. Furthermore paragraph 65 states that assets and liabilities that arose from business combinations whose acquisition dates precede the application of the revised IFRS 3 shall not adjusted upon application of the revised IFRS. The IASB concluded as a result that contingent consideration arising on business combinations whose acquisition dates preceded the application of revise IFRS 3 should be accounted for in accordance with old IFRS 3 rather than revised IFRS 3.

14 The ED proposes amendments to IAS 7, IAS 32 and IAS 39 to make this clear.

EFRAG's comments

15 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.

16 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.

17 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

Notes for EFRAG's constituents

18 In revising IFRS 3, the IASB replaced the term 'minority interests' with the term 'non-controlling interests' and also changed the definition.

(a) Minority interests were defined as that portion of the profit or loss and net assets of a subsidiary attributable to the equity interests that are not owned, directly or indirectly through subsidiaries, by the parent.

(b) NCI is defined as: the equity in a subsidiary not attributable, directly or indirectly, to a parent.

19 The IASB understands that some think that the amended definition has widened the scope of instruments that it covers, to include for example, the equity components of convertible bonds, warrants, option over own shares and options under share-based payment plans under IFRS 2 Share-based Payment (not held by the parent).

20 Paragraph 19 of revised IFRS 3 gives entities a choice as to how to measure NCI: NCI can be measured either at its acquisition date fair value or at the NCI's proportionate share of the acquiree's identifiable net assets. Some of those who think that the amended definition of NCI has widened the scope of instruments that it covers believe that the equity instruments included in NCI but not minority interests do not represent present ownership instruments and therefore do not share in any of the identifiable net assets on the business combination. They argue that it follows that, if an entity measures NCI as a proportionate share of the acquirer's identifiable assets, it should measure all components of equity other than those equivalent to minority interests at nil at the acquisition date.

21 The IASB believes that it is not appropriate to measure some equity instruments at nil because this will result in not recognising economic interests that other parties have in the acquiree. It is therefore proposing to amend paragraph 19 of the revised IFRS 3 to clarify that only certain components of equity fall under the measurement choice; other equity components should be measured at fair value at the acquisition date or under applicable IFRSs. For example, a share-based payment transaction

that is classified as equity shall be measured in accordance with IFRS 2 Share-based Payment *and the equity component of a convertible instrument shall be measured in accordance with IAS 32* Financial Instruments: Presentation*. The actual amendment proposed is as follows:*

> *19 For each business combination, the acquirer shall measure any non-controlling interest in the acquiree either at fair value or other measurement basis as required by IFRSs, except for the components of non-controlling interest that are present ownership instruments and entitle their holders to a pro rata share of the entity's net assets in the event of liquidation. The acquirer shall measure those components of non-controlling interest either at fair value or at the present ownership instruments' ~~non-controlling interest's~~ proportionate share of the acquiree's identifiable net assets.*

22 *The proposal is that the amendment should be applied for annual periods beginning on or after 1 July 2010. Earlier application is permitted.*

EFRAG's comments

23 First, we are somewhat puzzled to hear that the issue has arisen as a result of the revisions made to the definition of 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.

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

25 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 bring 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 and equity instruments 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

Notes for EFRAG's constituents

26 *Entities that are acquired in a business combination may have share-based payment transactions in place. Upon acquisition those plans may be replaced by awards issued by the acquirer. The acquirer may be obliged to replace the awards or decide to replace them voluntarily. The revised IFRS 3 states that:*

(a) when the acquirer is required to replace the awards, all or a portion of the market-based value of the new awards should be included in the consideration transferred for the business combination. IFRS 3 provides guidance on how to determine the amount that should be treated as consideration and the amount (if any) that should be accounted for as payroll cost post-business combination; and

(b) when the acquirer decides to voluntarily replace awards of the acquiree that would have expired automatically following the acquisition, all of the market-based value of the new awards should be treated as remuneration cost.

27 *IFRS 3 is however silent on the accounting treatment of:*

(a) share-based payment awards of the acquiree that are not replaced; and

(b) share-based payment awards issued by the acquirer when the acquirer is not obliged to replace the awards of the acquiree, and these would not have automatically expired following the acquisition.

28 *As a result, it seems that there are diverging views on how such awards should be accounted for. The IASB is proposing to address this by inserting in IFRS 3 the following requirements.*

(a) Entities shall apply to awards that are voluntarily replaced the same guidance in IFRS 3 applicable to awards that the acquirer is obliged to replace. If an award would automatically expire all the market-based measure of the new award is allocated to post-combination expense;

(b) Unreplaced awards that are fully vested at acquisition date are part of NCI and are measured at their fair values. Unreplaced awards that are not fully vested are measured at their market-based measure at acquisition date. The guidance in IFRS 3 applies to determine the portion of value to be allocated to post-combination cost.

29 *The amendment shall be applied for annual periods beginning on or after 1 July 2010 with the option of early adoption.*

EFRAG's comments

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

31 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.

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

Notes for EFRAG's constituents

32 In Annual Improvements that were issued in May 2008, the IASB amended IFRS 5 Non-current Assets Held for Sale and Discontinued Operations *to clarify that an entity that is committed to a sale plan involving loss of control of a subsidiary shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out in paragraphs 6-8 of IFRS 5 are met. This applies regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale.*

33 The IASB has been asked to clarify the applicability of IFRS 5 to an associate or jointly controlled entity when it is highly probable that control will be obtained and/or significant influence or joint control will be lost.

34 The IASB considered two issues relating to this request:

(a) Step down – Should an entity classify as held for sale an associate or a jointly controlled entity in accordance with IFRS 5 when it is highly probable that the entity will lose significant influence or joint control?

(b) Step up - Should an entity classify as held for sale an associate or a jointly controlled entity in accordance with IFRS 5 when it is highly probable that control will be obtained?

35 In the IASB's view, the loss of significant influence or joint control (ie a step down) is an economically similar event to the loss of control of a subsidiary and therefore should be accounted for in the same way. That means that an entity that is committed to a sale plan involving loss of significant influence or joint control shall classify all the assets and liabilities of that associate or joint venture as held for sale when the criteria set out in paragraphs 6-8 of IFRS 5 are met.

36 In relation to step up the IASB concluded that the held for sale classification applies only to an asset or disposal group that an entity intends to sell. It believes that this conclusion is supported by paragraph 6 of IFRS 5, which states that "an entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be <u>recovered through a sale transaction</u> rather than through continuing use" (emphasis added)*. It has also concluded that a step up does not involve a sale transaction, even though it could be argued that the interest in the associate or jointly controlled entity is derecognised and an interest in a subsidiary recognised. That is because it believes that the underlying economics of the transaction is to acquire an additional investment rather than selling one and replacing it with another*

investment. As a result, it has concluded that step ups do not fall within the scope of IFRS 5.

37 *The IASB is proposing to reflect these conclusions in IFRS 5 by making the following amendment:*

> 8A *An entity that is committed to a sale plan involving loss of control of a subsidiary or loss of significant influence of an associate or loss of joint control of a jointly controlled entity shall classify all the assets and liabilities of that subsidiary or all the interests in an associate or a jointly controlled entity 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.*

38 *The proposal is that this amendment shall be applicable for annual periods beginning on or after 1 January 2010. Earlier application is permitted.*

EFRAG's comments

39 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, significant influence or joint control of a subsidiary, an associate or a jointly controlled entity respectively shall classify all the assets and liabilities of that subsidiary or all the interests in an associate or a jointly controlled entity 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.

40 EFRAG agrees with the transitional provisions proposed by the IASB.

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

Notes for EFRAG's constituents

41 *IFRS 7* Financial Instruments: Disclosures *came into effect for annual periods beginning on or after 1 January 2007. A number of relatively minor issues arose during the first year of application which the IASB is proposing to deal with through the Annual Improvements project. In particular, the IASB is proposing to make the following amendments to IFRS 7:*

(a) *To state explicitly that the qualitative disclosures in paragraph 33 should support and enhance the quantitative disclosures in paragraphs 34–42. The IASB considers that an explicit emphasis on the interaction between qualitative and quantitative disclosures would contribute to disclosure of information in a way that better enables users to evaluate an entity's exposure to risks.*

(b) To remove the reference to materiality from paragraph 34(b) because the IASB believes that such a reference is unnecessary and could be confusing as it may suggest that except for this particular disclosure IFRS 7 requirements apply to immaterial items.

(c) To clarify that the requirement in paragraph 36(a) to disclose information about the maximum exposure to credit risk applies to financial assets whose carrying amounts do not reflect the reporting entity's maximum exposure to credit risk and off balance sheet exposures. The IASB reasons that the disclosure requirement should focus on the entity's exposure to credit risk that is not already reflected in the statement of financial position.

(d) To remove the requirement in paragraph 37(c) to disclose for instruments past due but not impaired and that are determined individually impaired the description of collateral held as security and their fair value. Because within a class of assets some might be over-collateralised while others might be under-collateralised, aggregate disclosure of the fair value of different collaterals might be misleading. The IASB believes that more useful information would be provided by disclosing the financial effect of collateral held as security in paragraph 36(b).

(e) To remove the requirement in paragraph 36(d) to disclose carrying amount of financial instruments renegotiated to avoid becoming past due or impaired for such reasons as:

(i) The difficulty in identifying financial assets whose terms have been renegotiated to avoid becoming past due or impaired (rather than for other commercial reasons).

(ii) Confusion as to whether the existing requirement applies only to financial assets that were renegotiated in the current reporting period or whether past negotiations of those assets should be considered.

(f) To clarify that the requirement in paragraph 38 applies only to foreclosed collateral held at the reporting date to be consistent with the objective to enable users to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.

42 The proposal is that these amendments shall be applied for annual periods beginning on or after 1 January 2011. Earlier application is permitted.

EFRAG's comments

43 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.

44 We have however some comments 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 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

Notes for EFRAG's constituents

45 Paragraph 106(d) of IAS 1 Presentation of Financial Statements requires entities to present a statement of changes in equity that shows, in the statement "for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from":

"(i) profit or loss;

(ii) each item of other comprehensive income; and

(iii) transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control."

46 The IASB received a request to clarify this requirement, because some constituents have interpreted paragraph 106(d)(ii) as a requirement to present each class of accumulated OCI on the face of the statement of changes in equity, which has created confusion among constituents. Such a requirement would also not be consistent with the requirements in US GAAP.

47 The IASB apparently did not intend paragraph 106(d) to be interpreted in this way. It is therefore proposing to amend paragraph 106(d) to make it clear that entities are permitted to present the reconciliation requirements for classes of accumulated other comprehensive income either on the face of the statement of changes in equity or in the notes to the financial statements.

48 The IASB is also proposing to amend paragraph 107 of IAS 1 to remove a reference to the amount of dividends which would become redundant with the amendment to paragraph 106(d).

49 The proposal is that these amendments shall be applied for annual periods beginning on or after 1 January 2011. Earlier application is permitted.

EFRAG's comments

50 EFRAG agrees that this is an issue that should be resolved. We also agree with the IASB's analysis of the issue and with its proposed amendment. Finally, we also agree with the proposed effective date and transition provisions.

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

Notes for EFRAG's constituents

51 IAS 8 provides guidance to preparers of financial reports in developing and applying accounting policies when there are no specifically applicable IFRSs. That guidance is based on the qualitative characteristics in the conceptual framework (the Framework).

52 The IASB and the US FASB are jointly developing a revised and converged Framework. The IASB expects to publish the first chapters of that revised Framework in the third quarter of 2009. Those chapters introduce some changes in to the qualitative characteristics referred to in IAS 8.

53 The IASB has decided that, as a matter of general policy, it will not change the many references that appear in existing IFRS to the qualitative characteristics to reflect those changes; rather, it will introduce the new terminology as and when it reviews and updates the IFRS involved for other reasons.

54 However, it is proposing to make one exception to this general policy. It is proposing to update the guidance of IAS 8 so that it is in accordance with the new terminology for the qualitative characteristics. Also, the IASB proposes to update the requirements relating to when an entity shall change an accounting policy so that these requirements correspond to the new terminology in the Framework. The IASB believes that these references merit being treated as an exception because the guidance is "essential to the application of IAS 8."

55 It is proposed that the amendments shall apply for annual periods beginning on or after 1 January 2011. Earlier application is permitted.

EFRAG's comments

56 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.

Our support is however subject to an important provison. The comment period for the Annual Improvements ED has started before the revised Framework material has been issued. It is therefore really possible for us only to agree that IAS 8 should be in accordance with the new chapters. It is not possible for us yet to assess whether the proposed amendment to IAS 8 reflects these new chapters.

57 We also believe that the proposed effective date and transition requirements are appropriate.

58 Having said that, we think it would have been preferable had essential amendments to IFRS of this kind had been issued as part of, or alongside, the Framework ED, thus helping 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

Notes for EFRAG's constituents

59 The IASB was asked to clarify whether an investor entity should, in its separate financial statements, apply the provisions of IAS 36 Impairment *or IAS 39* Financial Instruments: Recognition and Measurement *to test its investments in subsidiaries and jointly controlled entities and associates for impairment, when the investor measures those investments at cost in accordance with IAS 27* Consolidated and Separate Financial Statements*.*

60 Paragraph 38 of IAS 27 permits an entity that prepares separate financial statements to account for those investments either at cost or "in accordance with IAS 39". Both IAS 28 and IAS 31 refer to IAS 27 in respect to the accounting for associates and jointly controlled entities in the separate accounts of an investor.

61 However, IAS 27 does not provide specific guidance on testing for impairment of investments accounted for at cost in the separate financial statements. It seems that some think impairment testing should be done in accordance with IAS 36 and some in accordance with IAS 39.

62 The IASB has tentatively concluded that the IAS 39 model should be applied when impairment testing these investments. In the Basis for Conclusions the IASB explains that this conclusion is based on the IASB's view that the purpose of separate financial statements is to focus on the performance of the assets as investments. Using the fair value method in accordance with IAS 39 would provide a measure of the economic value of the investments.

63 In addition, the IASB is proposing to amend the reference in paragraph 38(b) of IAS 27 to an entity that prepares separate financial statements having the option of accounting for its investments in subsidiaries, jointly controlled entities and associates "in accordance with IAS 39", so that it instead refers to accounting for such investments at "fair value through profit or loss". This proposal is not explained in the Basis for Conclusions, although EFRAG understands that the IASB considers the amendment to be a clarification of what was always the intention.

64 The IASB also proposes to amend paragraph 2 of IAS 36, which states that IAS 36 shall apply in accounting for the impairment of all assets other than those listed in that paragraph 2. The proposed amendment is to add another exception, this time for "investments in subsidiaries, jointly controlled entities and associates that are accounted for at cost in the separate financial statements of the investor". This proposed amendment is consequential to the tentative decision discussed above that the impairment model to be used in the separate accounts should be the IAS 39 model.

EFRAG's comments

65 We agree that this is an issue that needs to be clarified, and that the Annual Improvements project is an appropriate place in which provide that clarification. We also support the proposed insertion of paragraph 38D. That is because in our view in the separate financial statements of the investor investments in subsidiaries, jointly controlled entities and associates should be tested for impairment using the impairment provisions in IAS 39, irrespective of whether the investments are carried at costs of at fair value (as permitted by IAS 27). In our view, these investments are similar to any other equity investments; therefore a similar impairment model should be used to test them for impairment. In addition, we do not think it is necessary to align the impairment model used in the separate accounts with the model used in the consolidated accounts as the purpose of the two sets of accounts is different.

66 On the other hand, we do not agree with the proposed amendment to paragraph 38(b) (ie replacing "in accordance with IAS 39" by "at fair value through profit or loss"). It is our understanding that the existing wording of paragraph 38(b) of IAS 27 is widely interpreted by those who apply IFRS 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 OCI. Assuming that interpretation is valid, the proposal will have the effect of narrowing down the accounting choice available under existing IFRS. Yet no reasoning or explanation is given for the change in the ED or its basis for Conclusions. We are not convinced it is appropriate to restrict the way in which an entity applies IAS 39 to such investments. And we would certainly like to see the IASB explain its reasoning for making such an important change before it proceeds with any amendment along these lines.

67 We understand that the IASB does not believe it is changing existing IFRS because 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 users of IFRSs cannot reasonably be expected to do any more than comply with the spirit of the standards as written. And the standards as written refer to comply with IAS 39, not

just one of the options available in IAS 39. Furthermore, BC65 of IAS 27, which sets out the reasoning behind the changes made in 2003, specifically refers to such investments being accounted for as "available-for-sale financial assets in accordance with IAS 39"; it does not refer to them being accounted for either at fair value through profit or loss in accordance with or as available-for-sale financial assets in accordance with IAS 39.

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

Notes for EFRAG's constituents

68 The amended IAS 27 issued in 2008 made various consequential amendments to other IFRSs. Some of the consequential amendments include transitional guidance and specify whether the amendments should be applied prospectively or retrospectively. However, the other consequential amendments (ie the amendments to IASs 21, 28, 31 and 39) are silent on transition. As a result, there is some uncertainty as to whether those consequential amendments are to be applied retrospectively or prospectively. With some limited exceptions, the amendments in amended IAS 27 are applied prospectively, so it might be assumed that that is the case for these consequential amendments too. On the other hand, paragraph 19 of IAS 8 requires retrospective application when a standard is otherwise silent on the subject.

69 The IASB has decided that the situation should be clarified. Furthermore, it has decided that the consequential amendments to IASs 21, 28 and 31 should be applied prospectively.

EFRAG's comments

70 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.

71 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

Notes for EFRAG's constituents

72 Paragraph 1 of IAS 28 Investments in Associates states that, although the Standard shall be applied in accounting for investments in associates, it does not apply to investments in associates held by (a) venture capital organisations or (b) mutual funds, unit trusts and similar entities including investment-linked insurance funds if that investment is upon initial recognition designated as at fair value through profit or loss or is classified as held for trading and accounted for in accordance with IAS 39. Such investments shall instead be measured at fair value through profit or loss.

73 The IASB received a request to clarify 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.

74 Paragraph 6 of IAS 28 is clear that the determination of significant influence includes both direct and indirect holdings. IAS 28 is however silent on whether both investments included within the scope of IAS 28 and those outside the scope of IAS 28 should be taken into account when determining the existence of significant influence.

75 The IASB noted that there was a divergence of views in practice, with some believing that it is necessary to:

(a) 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.

(b) 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).

76 Although the major overhaul of the IAS 28 is expected in not so distant future, the IASB decided to address this issue now, through the Annual Improvements process. Furthermore, it took the view that the approach described in (b)— under which the application of accounting policies at the consolidated level is dependent upon the business purpose of the investment—is the appropriate accounting to apply.

77 The IASB is therefore proposing to amend IAS 28 to clarify that different measurement bases can be applied to 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 in accordance with the scope exception in paragraph 1 of IAS 28. The proposal is that this amendment will come into effect for annual periods beginning on or after 1 January 2011. Earlier application is permitted.

EFRAG's comments

78 EFRAG agrees with the IASB's assessment of the issues and with its tentative decision. 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 value through profit or loss shall be applied to portion of an investment held by the previously mentioned subsidiaries to which the scope exclusion of IAS 28 applies.

79 EFRAG also agrees with the IASB's conclusion that the issues should be resolved as part of the 2009 annual improvements project.

80 Finally, EFRAG agrees with the effective date and transitional provisions.

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

Notes for EFRAG's constituents

81 The IASB has been considering whether some or all of the disclosures required by IFRS 7 Financial Instruments: Disclosures *for annual financial statements should also be required in interim financial statements.*

82 The IASB noted that, although IAS 34 does not require specific disclosures, it sets out disclosure principles to determine what information should be disclosed in an interim financial report. However, the IASB concluded that those principles needed to be further emphasised to ensure that appropriate disclosures were made in interim financial reports. It is therefore proposing to amend IAS 34 to place greater emphasis on the principles and to include additional examples relating to more recent disclosure requirements, such as fair value measurement disclosures.

83 The proposal is that this amendment will come into effect for annual periods beginning on or after 1 January 2011. Earlier application is permitted.

EFRAG's comments

84 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.

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

Issue 14: Proposed amendment to IAS 40 *Investment Property*

Notes for EFRAG's constituents

86 *Property held for rent or capital appreciation is investment property and should be accounted for in accordance with IAS 40* Investment Property*. Property bought with a view to resale is inventory, and should be accounted for in accordance with IAS 2* Inventories*.*

87 *Paragraph 9(a) of IAS 40 states that property intended for sale in the ordinary course of business or in the process of construction or development for such sale—for example, property acquired exclusively with a view to subsequent disposal in the near future or for development and resale—is an example of an item that is not investment property and is therefore outside the scope of IAS 40. However:*

(a) *paragraph 57 of IAS 40 states that transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by one or more of the events described in the paragraph. One of those events is commencement of development with a view to sale. Paragraph 57(b) states that at that point there should be a transfer from investment property to inventory. Paragraph 58 explains this further:*

> *Paragraph 57(b) requires an entity to transfer a property from investment property to inventories when, and only when, there is a change in use, evidenced by commencement of development with a view to sale. When an entity decides to dispose of an investment property without development, it continues to treat the property as an investment property until it is derecognised (eliminated from the statement of financial position) and does not treat it as inventory. Similarly, if an entity begins to redevelop an existing investment property for continued future use as investment property, the property remains an investment property and is not reclassified as owner-occupied property during the redevelopment.*

(b) *paragraph 50 of IAS 40—which is relevant only when IAS 40's cost model is being applied—states that investment properties shall be accounted for in accordance with IAS 16's requirements for that model, <u>other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with IFRS 5</u>* Non-current Assets Held for Sale and Discontinued Operations*.* (emphasis added) *Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with IFRS 5.*

88 *So, property acquired exclusively with a view to subsequent disposal in the near future or for development and resale is not investment property but, if property is initially acquired as investment property but the owner subsequently starts to develop the property with a view to selling it, paragraphs 57(b) and 58 of IAS 40 requires to be transferred immediately to inventories and accounted for in accordance with IAS 2 whilst paragraph 50 would require it to be accounted for under IFRS 5 (if a cost model is being applied).*

89 This appears to be inconsistent. In seeking to determine the best way of eliminating the inconsistency, the IASB has noted that the original classification of an asset (as either investment property or inventory) depends on the specific fact pattern of the entity. It further noted that if an asset is classified as investment property, it would be consistent with other changes of use for investment property (such as investment property under construction and investment property that is redeveloped for continued use as investment property) to require it to remain within investment property after its initial classification. As result, the IASB concluded that continuing to measure an investment property using the measurement model previously selected in accordance with IAS 40 provides the most relevant information.

90 The IASB is therefore proposing to amend IAS 40 so that:

(a) *commencing to develop the property with a view to sale no longer results in its owner having to transfer property from investment property to inventory,*

(b) *when an entity decides to dispose of an investment property, the property shall continue to be treated as an investment property until it is sold.*

(i) if the investment property meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), IFRS 5 shall be applied; and

(ii) if the criteria of IFRS 5 are not met, an entity shall provide the relevant disclosures required by IFRS 5 as if the criteria were met (because that would result in comparable information being provided regardless of whether further development would be required before sale).

91 The proposal is that this amendment shall be applied prospectively to all decisions to dispose of investment property made for annual periods beginning on or after 1 January 2011. Earlier application is permitted.

EFRAG's comments

92 EFRAG agrees that there is an issue here that needs to be addressed, and that it is appropriate to address it through the Annual Improvements project. Furthermore, on balance we agree with the proposed amendment.

93 The amendment proposed results in 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. On the other hand, it does not achieve consistency of treatment between property acquired as investment property but now being developed with a view to sale and property acquired with a view to sale. On balance EFRAG would prefer that investment properties are accounted for similarly until they are sold whether or not they will first undergo development. Accordingly EFRAG supports the proposal that commencement of development with a view to sale should not result in investment properties being transferred from investment property to inventories.

94 EFRAG has also discussed whether an entity should provide the disclosures required by IFRS 5 when it decides to sell an investment property but the requirements of IFRS 5 are not met – for example because the entity wants to develop the property before the selling process is initiated. On the one hand EFRAG thinks the proposal is an exception to the criteria of IFRS 5 for an asset to be held for sale and a significant extension of the scope of IFRS 5—and exceptions and extensions create complexity in accounting standards. On the other hand, EFRAG thinks that that providing the IFRS 5 disclosures in these circumstances would result in decision-useful information. On balance EFRAG supports the proposal to require the IFRS 5 disclosures to be provided when an entity decides to dispose of an investment property (even when the criteria to be classified as held for sale are not met).

95 Finally, we also support the proposed effective date and the transition requirements.

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

Notes for EFRAG's constituents

96 IFRIC 13 Customer Loyalty Programmes requires entities issuing award credits to account for those award credits separately from the rest of the transaction. This involves allocating the total consideration on the transaction between the award credits and the rest of the transaction. IFRIC 13 requires the consideration allocated to the award credits to be measured by reference to the award credits' fair value, "ie the amount for which the award credits could be sold separately."

97 Paragraph AG2 of IFRIC 13 provides guidance on how this fair value can be estimated. However, it has been brought to the IASB's attention that, because paragraph AG2 uses the term 'fair value' to refer to both the value of the award credits and the value of the awards for which the credits could be redeemed, the resulting guidance could be mis-interpreted. The IASB is therefore proposing to amend paragraph AG2 (and Example 1 in the illustrative examples) to clarify that, when the fair value of award credits is estimated by reference to the value of the awards for which they could be redeemed, the value of those awards shall be adjusted to reflect expected forfeitures.

98 The proposal is that this amendment shall come into effect for annual periods beginning on or after 1 January 2011. Earlier application is permitted.

EFRAG's comments

99 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.