European Financial Reporting Advisory Group

Annual Improvements Project
2010-2012 Cycle

Feedback to constituents – EFRAG Technical Expert Group Final Comment Letter

October 2012

1) Objective of this feedback statement

EFRAG published its final comment letter on the IASB Exposure Draft *Annual Improvements to IFRSs – 2010-2012 Cycle* on 11 September 2012. This feedback statement summarises the main comments received by EFRAG on its Draft Comment Letter and explains how those comments were considered by the EFRAG Technical Experts Group (EFRAG TEG).

2) Background

Annual Improvements Projects consider amendments to IFRS that are narrow in scope in areas that need clarifying or correcting. The amendments are not supposed to propose new principles or changes existing principles.

Issues submitted for consideration in the annual improvements process are considered and discussed by the IFRS Interpretations Committee and by the IASB. The IASB aims to publish an omnibus ED once a year.

On 3 May 2012, the IASB published for public comment an exposure draft containing proposed amendments to eleven IAS/IFRS as the proposed annual improvements in the 2010-2012 cycle.

3) Comment letters received

EFRAG published a draft comment letter on the proposals in June 2012[1]. Sixteen comment letters (or draft comment letters) were received from constituents. A further three comment letters were received after the EFRAG TEG meeting but before the publication of EFRAG's final comment letter. These comment letters were not discussed by EFRAG TEG, but they did not raise any new technical issues that had not been considered already.

4) Detailed analysis of issues, comments received and changes made to EFRAG final comment letter

Respondents' comments	Our response
General comments and cover letter	
Most respondents, commented only on those proposed amendments that were significant to them. One respondent agreed with EFRAG's	In its draft comment letter EFRAG generally supported the amendments proposed by the IASB, but in the covering letter

[1] Further details are available on the project page on the EFRAG website, including copies of comment letters received.

Respondents' comments	**Our response**
position without commenting on each proposed amendment. Another respondent stated that it believed the proposals increased the already lengthy disclosures required by IFRS and recommended that the IASB should consider how it could reduce disclosures in financial statements.	expressed reservations about the proposed amendments to IFRS 3 (Issue 2) and IAS 12 (Issue 7). However, EFRAG concurred with the concerns raised by constituents about the length of the disclosures and decided to state in the cover letter that disclosures should only cover relevant issues. EFRAG considered all comments made by constituents in response to its draft comment letter and considered them in drafting its final comment letter. However, this feedback statement only covers the most significant amendments and comments received thereon.

Issue 1: IFRS 2 *Share-Based Payment:* Definition of vesting conditions

The IASB identified the need to clarify the definition of a vesting condition in IFRS 2 *Share-based Payment* to ensure the consistent classification of conditions attached to a share-based payment as the standard does not separately define a performance condition or a service condition, but instead describes both concepts within the definition of vesting conditions. In addition, it intended to clarify some issues which had been raised by constituents in applying the definition of vesting condition in IFRS 2. *EFRAG's tentative position* In its draft comment letter EFRAG agreed with the IASB's assessment of the issues and with the proposed amendments. *Constituents' comments* Constituents agreed with EFRAG's tentative view and also expressed additional concerns on the drafting and identified other application issues. In addition, they noted their concerns on the increasing complexity of the standard.	EFRAG concurred with the concern raised by constituents that requirements of IFRS 2 have gradually become so complex as to reduce the understandability of the resulting financial information. Therefore, EFRAG cautioned the IASB against making further changes to IFRS 2, that might seem sensible and straight-forward when regarded in isolation, but that do not contribute to overall better principles-based financial reporting. In addition, EFRAG decided to call in its final comment letter for a post-implementation review of IFRS 2 to consider all implementation issues in their broader context.

Respondents' comments **Our response**

Issue 2: IFRS 3 *Business Combinations*: Subsequent measurement of contingent consideration

The proposed changes clarified the intention of the board that financial liabilities recognised in relation to contingent consideration should be measured at fair value. The proposed changes also removed references to '*other applicable IFRSs*' and inserted the words '*that meets the definition of a financial instrument*' when determining whether contingent consideration should be classified as equity or a liability. As a result, only the requirements of IAS 32 would apply.

EFRAG's tentative position

In its draft comment letter EFRAG agreed with the IASB's proposed changes, but reiterated its request that when changes were being made to IFRS 9 *Financial Instruments*, they should also be made to IAS 39 *Financial Instruments: Recognition and Measurement.*

Constituents' comments

Constituents raised concerns about two aspects:

(1) that the amendments appeared to state that all contingent consideration was either a financial liability or an equity instruments by deleting 'or other applicable IFRSs' from paragraph 40 of IFRS 3; and

(2) that the proposed amendments to paragraph 58 of IFRS 3 required non-financial contingent consideration liabilities to be measured at fair value through profit or loss.

A number of constituents also noted that the directions of the IFRS Interpretations Committee discussion on contingent consideration payable on acquisition of property, plant and equipments or intangible assets might not be consistent with the decisions taken in developing IFRS 3, where changes in subsequent measurement were required to

EFRAG during its discussions concurred with those who supported the amendments as they add clarity to IFRS 3. However, EFRAG believed that the IASB should further improve the wording of the amendments as its constituents did not understand the wording of the proposed amendments consistently.

Definition of contingent consideration as a financial liability

EFRAG concluded that the proposed deletion to "*other applicable IFRSs*" from paragraph 40 did not intend to prevent contingent consideration from being classified as a non-financial liability, but rather that contingent consideration in the form of a financial instrument should be classified as either a liability or equity based on the definitions in IAS 32. However, as the drafting was not clear to many constituents, particularly given the wording of paragraph BC2 of the amendment, EFRAG included in its comment letter a call for the wording to be improved in the final amendment.

Post-acquisition measurement of non-financial liabilities

In relation to post-acquisition measurement of non-financial liabilities, EFRAG believes that it was always clear that the IASB's intention was that all contingent consideration should subsequently be measured at fair value, as stated in the introduction to paragraph 58 of IFRS 3. This is explicitly set out in paragraph BC 355 of IFRS 3, which states "*In considering the subsequent accounting for contingent payments that are liabilities but are not derivatives, the boards concluded that, in concept, all liabilities for contingent payments should be accounted for similarly.*" The references to "IAS 37 or other IFRSs as appropriate" in paragraph 58(b)(ii) caused unneeded confusion as those standards also contain guidance on measurement bases other than fair value. EFRAG agreed that removing the reference would remove an area of

Respondents' comments

be recognised in profit or loss.

Our response

confusion and thus supported the inclusion of these amendments within the annual improvements.

EFRAG noted that the proposed amendments were not understood in the same way by all constituents. Therefore, EFRAG requested that the wording be improved to clarify that all contingent consideration, regardless whether or not it was a financial instrument, should subsequently be measured at its fair value with any gain or loss – or in the case of certain financial instruments – in other comprehensive income.

Other comments

EFRAG agreed that it should comment separately on future decisions made by the IFRS Interpretations Committee on contingent consideration payable on acquisition of property, plant and equipments or intangible assets at that stage, rather than as part of its comment letter on the Annual Improvements Project. EFRAG believed that the proposed amendments to IFRS 3 addressed an issue raised by constituents and could already reduce divergence in practice and improve the quality of financial information in the short-term. However, EFRAG noted in its comment letter that it believed that any further changes to IFRS 3 should be addressed during the post-implementation review of the standard and not on a piecemeal basis.

Issue 5: IAS 1 *Presentation of Financial Statements:* Current/non-current classification of liabilities

The IASB proposed to amend IAS 1 *Presentation of Financial Statements* so that an entity could classify a liability as non-current if it expected, and had such discretion, to refinance or roll over an existing liability for a period of at least twelve months from the balance sheet date, with the same lender at the same or similar terms.

EFRAG's tentative position

EFRAG agreed with the proposal, however it believed that the wording of the amendments should be improved in order to address concerns raised by its constituents.

Respondents' comments

EFRAG supported the amendments in its draft comment letter.

Constituent's comments

Constituents supported the aim of the IASB, but expressed reservations about consistency with derecognition criteria in IAS 39/IFRS 9, particularly with respect to situations in which the loan facility was moved within the lender's corporate structure.

Constituents were concerned that the amendments could have unintended consequences if they were not worded to reflect that what mattered was the borrower's perspective (irrespective of who the final lender would be).

A number of constituents also requested that the definition of what was meant by the same terms and conditions be moved from the Basis for Conclusions to the body of the standard.

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Issue 6: IAS 7 *Statement of Cash Flows:* Classification of interest paid that is capitalised as part of an asset

The proposed amendments changed IAS 7 *Statement of Cash Flows* to allow interest costs capitalised within Property Plant and Equipment under IAS 23 *Borrowing Costs* to be presented within the investing activities section of the cash flow statement rather than financing activities.

EFRAG's tentative position

EFRAG expressed support for the amendments in its draft comment letter.

Constituents' comments

Constituents generally supported the proposals. However some believed that the wording should be consistent with the definition of borrowing costs in IAS 23, which includes charges and some exchange

EFRAG's final comment letter was updated to state that the proposals should be consistent with borrowing costs as defined in IAS 23.

Respondents' comments

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differences, as well as interest.

Issue 7: IAS 12 *Income Taxes*

The proposed amendment was developed following a query about the accounting for deferred tax assets on unrealised losses recognised on available-for-sale debt securities.

EFRAG's tentative views

In its draft comment letter EFRAG appreciated the IASB's effort to address diversity in practice, but was concerned that the proposed amendments would have wider implications than the IASB anticipated. EFRAG also questioned whether, by proposing amendments that had a potentially broad scope rather than addressing the specific issue of deferred tax assets on available-for-sale debt instruments, the proposals still met the criteria in the IASB Due Process Handbook for inclusion in an Annual Improvement Project.

Constituents' comments

There was significant divergence in views among constituents. Those who agreed with the proposal believed that it only reaffirmed a current reporting practice and clarified IAS 12 *Income Taxes* and therefore supported the amendments.

Other constituents understood the underlying mechanics of IAS 12 differently and believed that the proposals were changing the requirements of IAS 12.

A number of constituents, even if they supported the aim of the amendments, requested clarification of the wording in order to improve their understandability as these amendments would have to be applied internationally.

Some constituents agreed with EFRAG that the amendments may have

EFRAG acknowledged that the objective of the amendments was to clarify the present wording in the standard so that it resulted clearer how the basic mechanics in current IAS 12 apply.

However, evidence from EFRAG's constituents indicated that the mechanics underlying IAS 12 were not understood consistently in practice. Therefore, the amendments could be viewed as changing, rather than clarifying, the existing requirements.

Accordingly, EFRAG requested that the drafting be improved to ensure consistent application in future.

In addition, given that the amendments did not narrowly address the original question raised, EFRAG raised a concern that the proposed amendments might not meet the criteria for being addressed as part of an annual improvement project.

If the IASB were to reaffirm that these amendments should be part of the annual improvements, EFRAG called for the IASB to perform additional outreach work and an extended analysis to ensure that the amendments do not introduce new problems in areas where none existed to date.

Respondents' comments

a wider impact than intended, especially given that the wording addresses more situations than just the initial question on accounting for deferred tax on available for sale debt instruments.

Our response

Issue 9: IAS 24 *Related Party Disclosures*: Key Management Personnel

The IASB proposed to amend IAS 24 *Related Party Disclosures* to address circumstances in which services of key management personnel are provided through a management entity rather than directly.

EFRAG's tentative position

In its draft comment letter EFRAG supported the proposals as they would result in improved disclosure.

Constituents' comments

Constituents, in general, supported the intention of the proposals but questioned how effective or useful they would be in the absence of context, such as the nature and extend of key management personnel provided by a management entity or in circumstances where the information is not presented or available.

EFRAG's final comment letter requested an amendment to require additional information on the nature and extent of key management personnel provided by such an entity.

In addition EFRAG noted that the amendments would also deter companies from establishing a separate management entity for the sole purpose of avoiding the more detailed disclosure required by paragraph 17 of IAS 24.