EFRAG
European Financial Reporting Advisory Group

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

11 September 2012

Dear Sir/Madam,

Re: Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the exposure draft, Exposure Draft *Annual Improvements to IFRSs 2010 – 2012 Cycle,* issued by the IASB on 3 May 2012 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

Our detailed comments and responses to the questions in the ED are set out in the appendix. To summarise we agree with most proposals in the ED and with the objective they are trying to achieve but EFRAG is concerned about the issues explained below.

IFRS 3 Business Combinations: Accounting for contingent consideration in a business combination

EFRAG agrees with the proposed amendments; however, we believe the IASB should not just make consequential amendments to IFRS 9 but also amend IAS 39 *Financial Instruments: Recognition and Measurement* as entities that do not apply IFRS 9 early may encounter the same issues. In addition, EFRAG believes that the IASB should also align IAS 39 *Financial Instruments: Recognition and Measurement* to the requirement in IFRS 9 *Financial Instruments* regarding the accounting for own credit risk on financial liabilities measured at fair value as it believes that users of the financial statements of entities that do not apply IFRS 9 early would also benefit from this improvement in financial reporting.

IAS 12 Income Taxes: recognition of deferred tax assets for unrealised losses on available-for-sale debt securities

EFRAG understands that the objective of the amendments is to clarify the present wording in the standard. However, EFRAG has in its due process collected evidence that different understandings of the basic mechanics of IAS 12 may lead to different interpretations of the current requirements. Furthermore the amendment is triggered by a specific and particular request while the amendments are to be implemented more widely. Therefore, EFRAG encourages the IASB to perform a thorough analysis of the consequences before making the decision whether to finalise the proposed amendments. If so, the Board should improve the drafting of the amendments so that they will be understood consistently.

Finally, as a general comment, EFRAG believes the proposed amendments increase the already lengthy disclosures required by IFRSs. In EFRAG's view only relevant information should be disclosed, so that detailed information does not obscure relevant information in the notes to the financial statements. Accordingly, we believe that the IASB should perform a specific assessment before proposing future amendments to IFRSs.

If you would like to discuss our comments further, please do not hesitate to contact Giorgio Acunzo or me.

Yours sincerely,

Françoise Flores
EFRAG Chairman

APPENDIX

EFRAG's responses to the questions raised in the ED

Question 1

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

Question 2

Do you agree with the proposed transitional provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose?

1 EFRAG agrees that, with the exception of the proposed amendments to IAS 12 *Income Taxes* as discussed below, the issues addressed by the IASB within the Exposure Draft *Annual Improvements to IFRSs 2010 – 2012 Cycle* ('the ED') meet the criteria of the IASB Due Process Handbook and therefore they should be resolved as part of the annual improvement project.

2 However, EFRAG has some doubts as to whether the consequences of the proposed amendments to IAS 12 have been considered in sufficient detail as this is not apparent from the Basis for Conclusion. In order for the IASB's constituents to be able to assess the impact of the proposed amendments, we recommend the IASB to analyse whether the proposal will change current practice in situations other than those that the proposed amendments aim to address.

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

EFRAG's response

EFRAG supports the proposed amendments, but is concerned about the increasing complexity of IFRS 2.

3 EFRAG agrees with the IASB's assessment of the issues and with its proposed amendments to address them as we believe that they would reduce divergence in the application of IFRS 2 *Share-Based Payment*.

4 EFRAG notes that the requirements of IFRS 2 have gradually become so complex as to reduce the understandability of the resulting financial information. Therefore, we would like to caution 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.

5 During our own due process, constituents raised many other application issues that they would want to see addressed. Accordingly, we believe that the IASB should carry out a post-implementation review of IFRS 2 to consider all implementation issues in their broader context.

Issue 2: IFRS 3 – Business combinations: Accounting for contingent consideration in a business combination

EFRAG's response

EFRAG welcomes the amendments as they add clarity to IFRS 3, but believes that the IASB should further improve the wording of the amendment.

EFRAG reiterates its request to amend IAS 39 to align it to the requirement in IFRS 9 regarding the accounting for own credit risk on financial liabilities measured at fair value.

6 EFRAG agrees with the IASB's assessment of the issues and with its proposed amendments to address them.

7 EFRAG notes that the wording of the proposed amendments to paragraph 40 of IFRS 3 was not understood consistently by constituents. The proposed wording was understood by many as limiting contingent considerations to being financial instruments. Therefore, we believe that the IASB should revise the wording to eliminate these possible misunderstandings.

8 Similarly, the wording of paragraph 58(b) of IFRS 3 was not understood uniformly by constituents. Therefore, we believe the IASB should strengthen the wording to clarify that all contingent consideration, regardless of whether or not it is a financial instrument, should subsequently be measured at its fair value with any gain or loss recognised either in profit or loss or – in the case of certain financial instruments – in other comprehensive income.

9 However, EFRAG believes that the IASB should also propose consequential amendments to IAS 39 *Financial Instruments: Recognition and Measurement* as entities that are not applying IFRS 9 early may encounter the same issues being addressed by these amendments.

10 In addition, EFRAG believes that the IASB should also align IAS 39 to the requirement in IFRS 9 regarding the accounting for own credit risk on financial liabilities measured at fair value. EFRAG believes that users of the financial statements of entities that do not apply IFRS 9 early would also benefit from this improvement in financial reporting.

11 Finally, while EFRAG supports the clarification of issues so as to eliminate diversity in practice, it encourages the IASB to address any future amendments to IFRS 3 within the planned post-implementation review of the standard.

Issue 3: IFRS 8 – Operating Segments: Aggregation of operating segments and reconciliation of the total of reportable segments' assets to entity's assets

EFRAG's response

EFRAG agrees with the amendments to IFRS 8 as these improve the understandability of financial information. However, EFRAG believes that the wording of the amendments should be improved in order to emphasise that entities are required first to comply with the overarching principles in IFRS 8 in providing disclosures on the aggregation of reporting segments.

12 EFRAG agrees with the IASB's assessment of the issues and with its proposed amendments to address them as it believes that they enhance the understandability of financial information.

13 EFRAG believes that in a principles-based accounting system, constituents should always refer to the overarching principles set out in paragraph 12 of IFRS 8 regarding aggregation. Accordingly, EFRAG believes that the wording of the amendments should be improved to make clearer that entities are first required to comply with such overarching principles in providing disclosures on the aggregation of reporting segments.

14 In addition, EFRAG believes that the examples for specific economic characteristics provided in the proposed paragraph 22(aa) in brackets should be deleted as it is within the management's discretion to provide disclosures consistently with the current guidance.

15 Finally, while EFRAG agrees that the proposed amendments meet the criteria to be part of the annual improvement project, we believe that any future amendments to IFRS 8 would best be considered as part of the IASB's post-implementation review of the standard.

Issue 4: IFRS 13 – Fair Value Measurement: Short-term receivables and payables

EFRAG's response

EFRAG welcomes the proposal to clarify that the practical expedient for measuring short-term receivables and payables is still available.

16 EFRAG welcomes the proposal as it clarifies the measurement requirements for short-term receivables and payables with no stated interest rate. We support the arguments provided by the IASB as we believe that – under current IFRSs – constituents should already refer to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Therefore, constituents should apply the concept of materiality in assessing the need to identify the financial component included in short-term receivables and payables with no stated interest rate and, if immaterial, measure them at their invoice amounts without discounting.

17 However, EFRAG believes that IAS 8 is the only standard governing the materiality concept. Therefore, we believe that the IASB should avoid introducing in other standards specific guidance on how the materiality concept should be applied. In addition, EFRAG believes that it could be helpful to provide constituents with educational materials that further explain the guidance in IAS 8. Such educational materials should provide guidance that allows entities to avoid making a costly evaluation to prove that the financial component in their short-term receivables and payables is immaterial.

18 EFRAG understands that the IASB has not included an effective date because the proposed amendments only aim to clarify rather than change existing practice. However, we believe that the IASB should provide a clear explanation of their reasoning by improving the wording of the proposed amendments to the Basis for Conclusions in IFRS 13.

Issue 5: IAS 1 – Presentation of Financial Statement: Current/non-current classification of liabilities

EFRAG's response

EFRAG agrees with the proposal, but believes that the wording of the amendments should be improved in order to refer to the existing guidance on derecognition of financial liabilities in IAS 39 and IFRS 9.

19 EFRAG supports the amendments as they provide enhanced guidance on the classification of liabilities. In addition, EFRAG believes that they could reduce diversity in practice by limiting the circumstances when paragraph 73 of IAS 1 *Presentation of Financial Statement* applies.

20 However, we believe that the wording could be improved to align it with the de-recognition criteria in IAS 39 and in IFRS 9; therefore, we believe that reference should be made to the derecognition criteria in the financial instruments standards.

21 In addition, EFRAG believes that the wording of the proposed amendments should be improved to take into account situations in which the loan facility does not change from the borrower's perspective. For example, when a loan is transferred between companies with the same ultimate parent (or when the original lender transfers the loan to a securitisation vehicle), such change should not affect the accounting outcome for the borrower.

22 Finally, EFRAG believes the definition of similar terms, included in the Basis for Conclusions of the proposed amendments, should be moved to the standard. Therefore, we suggest to improve the wording of the proposed amendments by adding the following text:

> 'Terms are similar if the amendment of the terms would be expected to result in no substantial businesses to change the rights and obligations of the parties to the loan facility'.

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

EFRAG's response

EFRAG agrees with the proposal. However we believe that the proposed amendments should refer to 'borrowing costs' rather than only to 'interest'.

23 EFRAG supports the amendments as they reduce diversity in practice and improve the understandability of financial reporting.

24 However, EFRAG believes that the IASB should have also to consider all other elements of borrowing costs as defined in paragraph 6 of IAS 23 Borrowing Costs (e.g. other charges and some exchange differences) rather than just referring to interest in paragraphs 33 and 33A of the proposed amendments.

Issue 7: IAS 12 – Income Taxes: Recognition of deferred tax assets for unrealised losses

EFRAG's response

EFRAG understands that the objective of the amendments is to clarify the present wording in the standard. However, EFRAG has in its due process collected evidence that different understandings of the basic mechanics of IAS 12 may lead to different interpretations of the current requirements. Furthermore the amendment is triggered by a specific and particular request while the amendments are to be implemented more widely. Therefore, EFRAG encourages the IASB to perform a thorough analysis of the consequences before making the decision whether to finalise the proposed amendments. If so, the Board should improve the drafting of the amendments so that they will be understood consistently.

25 EFRAG supports the IASB's efforts to address the issue and understands that the proposed amendments are intended to be consistent with the guidance already included in IAS 12 *Income Taxes*.

26 However, EFRAG is concerned that rather than addressing the issue of the recognition of deferred tax assets in relation to debt securities that are classified as available-for-sale, these proposed amendments potentially cover a much wider and more complex range of circumstances. As such, we question whether the proposals still meet the criteria, in paragraph 65A of IASB Due Process Handbook, to be addressed as part of the Annual Improvement Project.

27 Accordingly, even if the IASB were to affirm that these amendments should be part of the annual improvements, we believe the IASB should perform additional outreach work and extended analysis to ensure that these amendments do not introduce new problems in areas where none exist to date. This is particularly the case because the interaction between IAS 12 *Income Taxes* and complex tax legislation in many jurisdictions has the potential to result in some anomalous outcomes.

28 Finally, EFRAG believes that preparers differ in their understanding and interpretation of the basic mechanics of IAS 12. The wording of this amendment is also complex and will not in our view assist this understanding. Therefore, we believe that the IASB should improve the wording of the proposed amendments to IAS 12 to ensure their consistent application in the future.

Issue 8: IAS 16 and IAS 38 – Property, Plant and Equipment and Intangible assets: Revaluation method – proportionate restatement of accumulated depreciation

EFRAG's response

EFRAG agrees with the proposed amendments as it reduces divergence in practice.

Issue 9: IAS 24 – Related Parties Disclosure: Key management personnel

EFRAG's response

EFRAG supports these amendments but believes that the disclosures could be improved further.

29 EFRAG supports these amendments as they result in improved disclosures.

30 However, EFRAG believes that paragraph 18A should be improved by adding the following phrase:

> '…, as should the nature and extent (for example, the number of key management personnel provided) of the key management personnel services provided by such an entity.'

EFRAG believes that users would better understand the amounts recognised in the financial statements, and it would also deter companies from establishing a separate management entity for the sole purpose of avoiding the more detailed disclosures required by paragraph 17.

Issue 10: IAS 36 – Impairment of Assets: Harmonisation of disclosure for value in use and fair value less costs to sell

EFRAG's response

EFRAG agrees with the proposed amendments, but believes that they should be applied retrospectively.

31 EFRAG agrees with the proposed amendments as they provide a helpful clarification. We also agree that this issue should be resolved as part of the annual improvement project as it removes an existing inconsistency.

32 However, EFRAG believes that the amendments should be applied retrospectively as information about the comparative period is useful in itself and enhances comparability. In addition, the information that would be required to be disclosed already exists and should not be costly to collect. Finally, EFRAG noted that paragraph 140C of IAS 36 which was introduced in May 2008 was also not required to be applied prospectively.