EFRAG

European Financial Reporting Advisory Group

Jonathan Faull
Director General
European Commission
Directorate General for the Internal Market
1049 Brussels

29 August 2012

Dear Mr Faull

Adoption of *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (Amendments to IFRS 10, IFRS 11 and IFRS 12)

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 *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (Amendments to IFRS 10, IFRS 11 and IFRS 12) ('the Amendments'), which were issued by the IASB on 28 June 2012. It was issued as an Exposure Draft in December 2011 and EFRAG commented on that draft.

The objective of the Amendments is to clarify the IASB's intention when first issuing the transition guidance in IFRS 10 *Consolidated Financial Statements*. The Amendments also provide additional transition relief in IFRS 10, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. Furthermore, for disclosures related to unconsolidated structured entities, the Amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied.

The Amendments become effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted, however entities shall disclose that fact.

EFRAG has carried out an evaluation of the Amendments. As part of that process, EFRAG issued its initial assessment 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 principle of 'true and fair view' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

- 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 is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendments and, accordingly, EFRAG recommends their adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

In its final endorsement advice letter on IFRS 10 to the European Commission, EFRAG recommended that the mandatory effective date of IFRS 10, IFRS 11, IFRS 12, IAS 27 (2011) and IAS 28 (2011) to be 1 January 2014, with early adoption permitted. Consistent with EFRAG's recommendation, the Accounting Regulatory Committee voted on 1 June 2012 to recommend endorsement of the standards for adoption with the mandatory effective date of 1 January 2014.

In order to align the mandatory effective date of the Amendments with the effective date of IFRS 10, IFRS 11 and IFRS 12, EFRAG's recommendation is to defer the mandatory effective date of the Amendments from 1 January 2013 to 1 January 2014, with early adoption permitted.

On behalf 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

Françoise Flores
EFRAG Chairman

APPENDIX 1
BASIS FOR CONCLUSIONS

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12) ('the Amendments').

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

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 technical criteria for the European endorsement, 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 different is that EFRAG's thinking may evolve.

Does the accounting that results from the application of Document reference meet the technical criteria for EU endorsement?

1 EFRAG has considered whether *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)* ('the Amendments') meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that the Amendments:

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

(b) 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.

EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt the Amendments.

2 The Amendments clarify the following aspects of IFRS 10:

(a) *Date of initial application:* is the beginning of the annual reporting period in which IFRS 10 is applied for the first time.

(b) *Interests in investees that were disposed of during a comparative period under IFRS 10:* relief is provided from retrospective application of IFRS 10 if an investor's interests in investees, that were not consolidated under IAS 27/SIC-12 but would be consolidated under IFRS 10, were disposed of before the date of initial application of IFRS 10.

(c) *The version of IFRS 3 Business Combinations to use when applying IFRS 10:* If control was obtained *after* the effective date of IFRS 3 (2008), then IFRS 3 (2008) shall be used for the purposes of restating the comparatives. If control was obtained *before* the effective date of IFRS 3 (2008), an entity is allowed to apply either IFRS 3 (2008) or the previous version of IFRS 3 (issued in 2004) and the corresponding version of IAS 27/IFRS 10.

3 In EFRAG's view, amendments (a), (b) and (c) are straightforward and do not raise any new concerns. For this reason, they are not discussed specifically in this Appendix.

4 The Amendments also provide transition relief in the following two main areas of transition in IFRS 10, IFRS 11 and IFRS 12.

(a) eliminate the requirement to adjust comparatives that exceed the minimum requirements under IFRSs; and

(b) provide relief from comparative information under IFRS 12 in relation to unconsolidated structured entities.

5 The amendments in paragraph 4 apply only in the period when an entity adopts IFRS 10, IFRS 11 and IFRS 12. These are discussed in the paragraphs below.

Comparatives for entities that need to provide more than the immediately preceding period for IFRS 10, IFRS 11 and IFRS 12

6 This amendment affects those companies that provide (are required or do so on a voluntary basis) more than one comparative period when they implement IFRS 10, IFRS 11 and IFRS 12, and affects comparative information in two ways:

(a) It limits the requirement for full retrospective application in IFRS 10, IFRS 11 and IFRS 12, by requiring only one comparative period in the year an entity adopts these standards.

(b) When IFRS 10 and IFRS 11 are adopted, an entity is required to disclose the amount of the adjustment or affected financial statement line items for the *current period of change and for each prior period presented,* as required under paragraph 28 (f) of IAS 8. The Amendments limit the quantitative information required by IAS 8 to the immediately preceding period

Relevance

7 Information is relevant 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.

8 EFRAG considered whether this amendment would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

9 In EFRAG's view, the companies affected by this amendment provide as much relevant information as companies that only comply with the minimum comparative disclosure requirements contained in IAS 1 *Presentation of Financial Statements.*

Also, companies are permitted (but not required) to present or adjust comparative information for earlier periods.

10 EFRAG notes that the amendment would permit the earliest comparative periods to be presented on the same basis as they were presented in the previous set of financial statements, which would be more information than entities that only provide the minimum amount of information required by IAS 1.

11 For the reasons stated above, EFRAG's overall assessment is that this amendment meets the relevance criterion.

<u>Reliability</u>

12 EFRAG also considered the reliability of the information that will be provided by applying this amendment. 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 what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

13 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

14 The amendments require companies to state which comparative information has not been restated and the basis on which it has been prepared. For this reason, EFRAG does not believe that the amendments affect the reliability of the financial information.

15 EFRAG's overall assessment is that this amendment satisfies the reliability criterion.

<u>Comparability</u>

16 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 unlike items and events should be accounted for differently.

17 EFRAG has considered whether the amendment results in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

18 EFRAG generally believes that providing information for one comparative period generally meets the comparability criterion. Also, EFRAG notes that the relief in relation to comparative information is limited to the period when IFRS 10, IFRS 11 and IFRS 12 are first adopted.

19 EFRAG acknowledges that the amendment relating to paragraph 28(f) of IAS 8 will have some negative effect on comparability of information as users will not be provided with the amount of the adjustment or affected financial statement items for the *current period* that explains the effect of adopting IFRS 10 and IFRS 11 on an entity's financial results. However, users will have this information for the immediately preceding period.

20 For the reasons stated above, EFRAG's overall assessment is that this amendment satisfies the comparability criterion.

<u>Understandability</u>

21 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.

22 Although there are a number of aspects to the notion of 'understandability', EFRAG notes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

23 In EFRAG's view, this amendment does not introduce any new complexities that may impair understandability, but clarifies the requirement for comparative information both on a mandatory and on a voluntary basis.

24 EFRAG's overall assessment is that this amendment satisfies the understandability criterion.

Disclosure on IFRS 12 for unconsolidated structured entities

25 This amendment eliminates the requirement to present comparative information for the disclosures relating to unconsolidated structured entities for any period before the first annual period for which IFRS 12 is applied. Therefore, only current period information will be required.

<u>Relevance</u>

26 Information is relevant 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.

27 EFRAG considered whether this amendment would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

28 EFRAG believes that the information required in IFRS 12 about unconsolidated structured entities, is useful to users as it addresses user concerns about the lack of information regarding the nature and extent of an entity's involvement in unconsolidated structured entities and the risks resulting from that involvement. The amendment will require entities to provide this information for the *current period only*, when IFRS 12 is first adopted. Also, companies are permitted (but not required) to present or adjust comparative information for earlier periods.

29 In EFRAG's view, the primary purpose of producing information about unconsolidated structured entities is to provide users with information about an entity's exposure to risks that arise from its involvement in those entities. Therefore, presenting the required information for the current period, results in the presentation of relevant information. EFRAG further notes that the relief in relation to comparative information is limited to the period when IFRS 12 is first adopted.

30 For the reasons stated above, EFRAG's overall assessment is that this amendment meets the relevance criterion.

Reliability

31 EFRAG also considered the reliability of the information that will be provided by applying this amendment. 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 what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

32 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

33 EFRAG acknowledged that entities might have concerns with reliability until they have the processes in place to obtain the required information on a timely basis. For some companies having reliable information for comparative periods of previously unconsolidated structured entities might be challenging. In EFRAG's view, the amendment addresses this concern, and does not raise any concern about reliability of information.

34 The amendment requires entities to state which comparative information has not been restated and explain the basis on which it has been prepared. This will ensure that users are informed of the basis of the information, and therefore ensure faithful representation.

35 EFRAG's overall assessment is that this amendment satisfies the reliability criterion.

Comparability

36 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 unlike items and events should be accounted for differently.

37 EFRAG has considered whether the amendment results in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

38 EFRAG notes that the relief in relation to comparative information is limited to the period when IFRS 12 is first adopted.

39 As explained in the assessment in the 'relevance' criterion, EFRAG believes that the primary purpose of producing information about unconsolidated structured entities is to provide users with information about an entity's exposure to risks that arise from its involvement in those entities.

40 EFRAG believes that the transitional relief on the comparative disclosures will capture prior period risk exposures in relation to risks that still exist in the current period, and which have materialised in the current period. However, users will only be able to assess changes in risk exposures after the first period in which IFRS 12 is applied.

41 For the reasons explained above, EFRAG's overall assessment is that this amendment satisfies the comparability criterion.

<u>Understandability</u>

42 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.

43 Although there are a number of aspects to the notion of 'understandability', EFRAG notes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

44 As a result, EFRAG is of the view 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.

45 EFRAG believes that the amendment does not introduce any new complexities that may impair understandability. Therefore, EFRAG's overall assessment is that this amendment satisfies the understandability criterion.

True and Fair

46 EFRAG's has concluded that the information resulting from the application of the Amendments would not be contrary to the true and fair view principle.

European public good

47 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendments.

Conclusion

48 For the reasons set out above, EFRAG has concluded that the Amendments satisfy the technical criteria for EU endorsement and EFRAG should therefore recommend their endorsement.