EFRAG
European Financial Reporting Advisory Group

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

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Dear Mr Faull

Adoption of *Annual Improvements to IFRSs 2011-2013 Cycle*

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 *Annual Improvements to IFRSs 2011-2013 Cycle* ('the Amendments'), which were issued by the IASB on 12 December 2013. It was issued as an Exposure Draft in November 2012 and EFRAG commented on that draft.

The objective of the Amendments is to address non-urgent, but necessary issues discussed by the IASB during the project cycle that began in 2010 on areas of inconsistency in IFRSs or where clarification of wording is required.

The Amendments become effective for annual periods beginning on or after 1 July 2014. Earlier application is permitted, however entities shall disclose that fact.
Note to constituents

The Amendments refer to IFRS 9 *Financial Instruments*, which has not yet been endorsed in the European Union. These references to IFRS 9 are not addressed in this Endorsement Advice and will be considered together with the related requirements in IFRS 9.

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's evaluation does not cover the amendments IFRS 1 *First-Time Adoption of International Financial Reporting Standards*, as they only affect the basis for conclusions of that standard, which is not part of IFRS as adopted by the European Union.

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 Article4(3) of Council Directive 2013/34/EU; 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 Amendments and, accordingly, EFRAG recommends their adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

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
BASIS FOR CONCLUSIONS

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Annual Improvements to IFRSs 2011-2013 Cycle *('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 difference is that EFRAG's thinking may evolve.

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

1 EFRAG has considered whether 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 4(3) of Council Directive 2013/34/EU; 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 EFRAG notes that of the four subjects addressed by the Amendments, the two subjects listed below are clarifications or corrections of existing IFRS:

(a) IFRS 3 *Business Combinations* – Scope exceptions for joint ventures; and

(b) IFRS 13 *Fair Value Measurement* – Scope of paragraph 52 (portfolio exception).

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

4 Furthermore, the amendments to IFRS 1 *First-Time Adoption of International Financial Reporting Standards* only affect the basis for conclusions of that standard

– which are not part of IFRS as adopted by the European Union – and have not been considered below. In addition, the amendments to IFRS 13 *Fair Value Measurement* refer to IFRS 9 *Financial Instruments*, which has not yet been endorsed in the European Union.

5 In EFRAG's view, the amendments to IAS 40 *Investment Property*, *'Clarifying the interrelationship between IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property'*, may result in changes to the existing accounting requirements or additional guidance on the implementation of those requirements which could affect the relevance, the understandability, the reliability and the comparability of financial information. Accordingly, these amendments are discussed below.

Relevance

6 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.

7 EFRAG considered whether the Amendments to IAS 40 *Investment Property* 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.

8 The objective of the Amendments to IAS 40 is to clarify that judgement should be applied in determining whether a transaction is (1) the acquisition of an asset (or a group of assets) that should be accounted in accordance with IAS 40 or (2) a business combination that should be accounted for in accordance with IFRS 3.

9 In addition, these amendments clarify that this judgement is not based on paragraphs 7 to 14 of IAS 40, but is instead based on the definition of business in IFRS 3.

10 The Amendments to IAS 40 clarify that IFRS 3 and IAS 40 are not mutually exclusive in making the distinction between (1) the purchase of an investment property with (insignificant) ancillary services and (2) the acquisition of a business. In EFRAG's view, this will result in information that is relevant as entities will be required to use the most appropriate accounting requirements in current Standards, which will result in information that is more useful to users of financial statements.

11 In addition, EFRAG believes that by permitting retrospective application of the Amendments to IAS 40 when the information needed to do so was obtained at the initial accounting of the investment property (business), the Amendments to IAS 40 enable entities to produce relevant financial information.

12 Therefore, EFRAG's overall assessment is that the Amendments to IAS 40 would result in the provision of relevant information; and therefore they satisfy the relevance criterion.

Reliability

13 EFRAG also considered the reliability of the information that will be provided by applying the Amendments to IAS 40. 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.

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

15 The Amendments to IAS 40 do not introduce a new accounting treatment; rather they require an entity to use guidance in IAS 40 and IFRS 3 to account for the acquisition of the investment property (business) so that it result in financial information that represents faithfully the transaction.

16 In addition, we note that the Amendments to IAS 40 only permit retrospective application provided that the information needed to apply the general recognition and measurement requirements both in IAS 40 and IFRS 3 was obtained at the date of the acquisition of the investment property (business). EFRAG believes that by preventing the undue use of hindsight, the Amendments to IAS 40 ensure a minimum level of reliability.

17 Accordingly, EFRAG's overall assessment is that the Amendments to IAS 40 would raise no concerns about risk of error or bias; and therefore they satisfy the reliability criterion.

Comparability

18 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.

19 EFRAG has considered whether the Amendments to IAS 40 result 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.

20 EFRAG notes that the Amendments to IAS 40 clarify that entities, which acquire an investment property with associated insignificant ancillary services, will be required to consider both the requirements in IFRS 3 and IAS 40 in selecting the appropriate accounting treatment. Therefore, EFRAG believes that this clarification will reduce divergence in practice.

21 Furthermore, EFRAG notes that the transitional provisions allow entities to apply retrospectively the proposals if the information needed is available to the entity. EFRAG believes that retrospective application of a requirement ensures the comparability of financial information.

22 Therefore, EFRAG's overall assessment is that the Amendments to IAS 40 satisfy the comparability criterion.

Understandability

23 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.

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

25 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments to IAS 40 is understandable, is whether that information will be unduly complex.

26 The Amendments clarify that an entity that acquires an investment property with associated insignificant ancillary services should consider both current requirements in IAS 40 and in IFRS 3 to select the appropriate accounting treatment.

27 In EFRAG's view, the Amendments to IAS 40 do not introduce any new complexities that may impair understandability. Therefore, EFRAG's overall assessment is that the Amendments to IAS 40 satisfy the understandability criterion in all material respects.

True and Fair

28 EFRAG 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

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

Conclusion

30 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.