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European Commission
Directorate General for the Internal Market
1049 Brussels

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Dear Mr Holmquist

Adoption of the Improvements to IFRS issued in April 2009

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 adoption of the *Improvements to IFRS* issued in April 2009 (the Amendments). The individual amendments involved were issued in two Exposure Drafts in October 2007 and August 2008 and EFRAG commented on those drafts.

The IASB has adopted an annual process to deal with non-urgent albeit necessary amendments to IFRS (the annual improvements process). Issues dealt with in this process arise from matters raised by the International Financial Reporting Interpretations Committee (IFRIC) and suggestions from IASB staff or practitioners, and focus on areas of inconsistency in IFRSs or where clarification of wording is required. There are 16 individual amendments in the Annual Improvements standard issued in April 2009, covering a variety of subjects. The effective date for each amendment is included within each area of affected IFRS.

EFRAG has carried out an evaluation of the Amendments. As part of that process, EFRAG issued an initial evaluation of the Amendments against the EU endorsement criteria 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 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
- they 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's endorsement advice on Improvements to IFRS (Issued April 2009)

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Amendments and, accordingly, EFRAG recommends their adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

A minority of EFRAG members have concerns about some of the individual amendments making up the Amendments that cause those members to believe that EFRAG should not recommend those particular individual amendments for endorsement. The reasoning of those members is explained in the attached 'Appendix 2 – Dissenting views'.

On behalf of the members 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

Stig Enevoldsen
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 Amendments.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

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 European endorsement criteria, 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.

Introduction

- 1 When evaluating the Amendments, EFRAG considered the following questions:
 - (a) Are the requirements of the Amendments consistent with the IASB's *Framework for the Preparation and Presentation of Financial Statements* ('the Framework')?
 - (b) Would the Amendments' implementation result in an improvement in accounting?
 - (c) Does the information resulting from the Amendments' application meet the criteria for EU endorsement?
- 2 Having formed tentative views on the above issues following an initial assessment, EFRAG issued that initial assessment on 29 July 2009 and asked for comments on it by 4 September 2009. EFRAG has considered all the comments received in response, and the main comments received are dealt with in this appendix.

Are the requirements of the Amendments consistent with the Framework?

- 3 EFRAG considered whether the Amendments' requirements are consistent with the Framework. When EFRAG considered whether existing IFRSs should be endorsed, it considered whether they were consistent with the Framework. As the Amendments involve providing clarification and additional guidance on some aspects of those existing IFRSs—and as a result do not introduce fundamental changes to existing IFRS literature—EFRAG concluded that the Amendments are consistent with the provisions in the Framework.

Would the Amendments' implementation result in an improvement in accounting?

4 EFRAG notes that, of the fifteen amendments in the standard that will affect IFRS as endorsed for use in the EU, eleven are clarifications or corrections of existing IFRS or are amendments that are consequential to changes previously made to IFRS.¹ They are:

- IFRS 2 – Scope of IFRS 2 and revised IFRS 3
- IFRS 5 – Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued
- IAS 1 – Current/non-Current assets classification of convertible instruments
- IAS 7 – Classification of expenditures on unrecognised assets
- IAS 38 – Additional consequential amendments arising from revised IFRS 3
- IAS 38 – Measuring the fair value of an intangible asset acquired in a business combination
- IAS 39 – Treating loan prepayment penalties as closely related embedded derivatives
- IAS 39 – Cash flow hedge accounting
- IAS 39 – Hedge accounting
- IFRIC 9 – Scope of IFRIC 9 and IFRS 3
- IFRIC 16 – Amendment to the restriction on the entity that can hold hedging instruments

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

5 The other four amendments that will affect IFRS as endorsed for use in the EU involve changes to the existing requirements or additional guidance on the implementation of those requirements. Those amendments are:

- IFRS 8 – Disclosure of information about segment assets
- IAS 17 – Classification of leases
- IAS 36 – Unit of accounting for goodwill impairment test

¹ There is a sixteenth amendment—an amendment to the guidance given in the appendix of IAS 18 concerning the identification of agent/principal relationships. However, as this amendment does not amend material endorsed for use in the EU, it has not been assessed for compliance with the EU endorsement criteria or in cost/benefit terms.

- IAS 39 – Scope exemption for business combination contracts

These four amendments are discussed in the paragraphs that follow.

IFRS 8 – Disclosure of information about segment assets

- 6 IFRS 8 contains an apparent inconsistency, in that paragraph 23 requires a measure of total assets to be disclosed for each reportable segment, whilst paragraph 25 states that information about segment assets should be disclosed only if such information is regularly provided to the chief operating decision maker. This amendment eliminates the inconsistency by amending paragraph 23 so that an entity is required to report a measure of assets and of liabilities for each reportable segment only if such an amount is regularly provided to the chief operating decision maker. Thus, the amendment clarifies that the principle underpinning the rest of IFRS 8—that a piece of segment information should not be required to be disclosed if it is not regularly provided to the chief operating decision maker—applies to segment information about assets and liabilities.
- 7 The effect of this amendment on the segment information provided will depend on the circumstances of the entity involved. For example, if an entity has only immaterial amounts of assets the amendment is likely to have no effect on the segment information provided. It is also likely to have no effect if the entity has material amounts of assets and regularly provides information about segment assets to the chief operating decision maker. However, the amendment could result in a reduction in the segment information provided if the entity has material amounts of assets but does not regularly provide information about segment assets to the chief operating decision maker. EFRAG has considered the implications of this potential loss of segment information carefully.
- (a) Some members are concerned that it will mean the omission from the financial statements of relevant information. In their view segment information about assets is always relevant information unless the assets involved are immaterial. Yet empirical evidence suggests that such information is not always regularly provided to the chief operating decision maker.
- (b) However, the majority of EFRAG members do not share that concern. They note that disclosure of segment information about assets only if this information is regularly provided to the chief operating decision maker is consistent with the general principle underlying IFRS 8, and that EFRAG has previously concluded that IFRS 8 meets the EU endorsement criteria. These EFRAG members note that, when an entity with material amounts of assets does not disclose segment assets (because such information is not being provided regularly to the chief operating decision maker), that in itself is useful information that would be obscured were the entity required to disclose segment assets in such circumstances.

IAS 17 – Classification of leases

- 8 In some countries, property rights are obtained through long-term leases of land. Those leases can be so long that the residual value interest is small relative to the other risks and rewards involved. When determining whether a land lease is an operating lease or a finance lease, proper weight needs to be given to all the relevant

factors, so it is important that too much emphasis is not given to the residual value interest (in other words, to the fact that land has an indefinite life).

- 9 Some of the wording in existing IAS 17 seems inconsistent with this principle and, as a result, is causing some to treat all land leases as operating leases. The amendment makes it clear that some land leases could be finance leases.
- 10 EFRAG believes that this amendment moves the treatment of land leases onto the same basis as other leases and ensures that the way in which they are classified reflects their substance. As such, EFRAG believes the representational faithfulness (and therefore reliability) of the information provided about such leases will be enhanced, and that in turn will enhance the comparability and understandability of the information provided. It ought too to result in users being provided with more relevant information.

IAS 36 – Unit of accounting for goodwill impairment test

- 11 When a business combination occurs that generates goodwill, IFRS requires the acquirer to allocate the goodwill to its cash-generating units or groups of cash-generating units (CGUs), and to assess the goodwill for impairment on an annual basis. For the purpose of impairment testing, paragraph 80 of IAS 36 says that such a unit or group of units shall, inter alia, “represent the lowest level within the entity at which goodwill is monitored for internal management purposes” and shall “not be larger than an operating segment determined in accordance with IFRS 8.”
- 12 Paragraph 12 of IFRS 8 permits two or more operating segments to be aggregated into a single segment in certain circumstances. As a result, there has been some uncertainty as to whether the reference in paragraph 80 of IAS 36 is to the operating segments prior to or after disaggregation. The amendment clarifies that, for the purpose of impairment testing, goodwill should be allocated based on operating segments before aggregation. In other words, at the lowest operating segment level.
- 13 EFRAG believes that the amendment will result in impairment testing being done at the appropriate segment level. Such an approach is also more consistent with the way IAS 36 looks at impairment testing, which is based on the lowest level within the entity at which goodwill is monitored for internal management purposes. Furthermore the amendment will eliminate the current diversity in practice in the way goodwill is allocated to a CGU or a group of CGUs. As such, EFRAG believes that overall the amendment will provide information that will improve financial reporting and represent more faithfully and therefore more reliably the way management performs impairment tests on goodwill.

IAS 39 – Scope exemption for business combination contracts

- 14 A general principle in IFRS is that accounting for derivatives at fair value through profit or loss provides relevant information for users of financial statements. As a result, derivatives are generally required by IFRS to be accounted for at fair value through profit or loss. There are some exceptions to this. For example, paragraph 2(g) of IAS 39 exempts “contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date” even though such contracts are derivative contracts.

- 15 There has been some uncertainty as to exactly what kind of contracts fall within the scope of this exemption, with some believing it is applicable not only to binding contracts between an acquirer and an acquiree (ie contracts that meet the definition of a derivative forward contract to buy or sell a subsidiary) but also to:
- (a) contracts between an acquirer and a vendor to buy or sell an acquiree at a future date that are not binding on one of the parties (ie contracts that meet the definition of a derivative option contract); and/or
 - (b) contracts to buy or sell an associate at a future date.
- 16 In view of this uncertainty, the IASB has, through this amendment, clarified the situation. The IASB concluded that the purpose of paragraph 2(g) of IAS 39 was to exempt from the provisions of IAS 39 contracts for business combinations—not contracts for other types of transaction—that both parties are obliged to complete (ie forward contracts that are binding for both parties). The amendment therefore makes it clear that the contracts described in sub-paragraphs (a) and (b) above are required to be accounted for as derivative contracts under IAS 39.
- 17 Some EFRAG members are concerned about this clarification, because they believe it changes the existing treatment of the contracts described in sub-paragraphs (a) and (b) above in a way that reduces the usefulness of the information provided. In their view, it would not be representationally faithful to account for such contracts as derivatives. However, the majority of EFRAG members believe that the amendment does not change the exemption; it merely clarifies what has always been the IASB's intention. (For example, the words 'acquirer' and 'business combination' were used in the wording of the exemption to make it clear that the exemption did not apply to contracts to buy or sell an associate.) In these members' view, although there could be valid reasons to extend the exemption to include other types of contracts—such as for example the contracts described in sub-paragraphs (a) and (b) above—that is not a relevant factor in considering whether this amendment should be endorsed. For that purpose, one must assess the amendment made—not the amendment the IASB could have made—against the endorsement criteria. In the view of that majority of EFRAG members, the amendment does not change the existing exemption.

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

- 18 As already mentioned, EFRAG has previously concluded that the various IFRSs affected by the Amendments meet the endorsement criteria. Furthermore, as explained above, EFRAG believes that the Amendments are consistent with the Framework. Finally, the assessment of the majority of EFRAG members is that each of the Amendments is likely either to improve the financial information provided or to have no effect on that information. The majority of EFRAG members has therefore concluded that each of the Amendments meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management. A minority of EFRAG members has reached a different conclusion on some of the amendments, and their dissenting view is set out in appendix 2.

- 19 EFRAG also concluded that there was no reason to believe that the information resulting from the application of the Amendments would be contrary to the true and fair view principle or that their implementation in the EU would be contrary to the European interest.

Conclusion

- 20 The majority of EFRAG members have therefore concluded that each of the amendments satisfies the criteria for endorsement in the EU and that EFRAG should recommend that each of the amendments be endorsed for use in the EU.

Appendix 2 Dissenting views

The views of the EFRAG members who voted against recommending endorsement of one or more of the individual amendments making up the Amendments are explained in this appendix.

- 1 A minority of EFRAG members do not share the conclusion of the majority of EFRAG members that each of the amendments making up the Amendments meet the EU endorsement criteria and therefore should be recommended for endorsement. In their view one or more of the individual amendments do not meet the criteria and therefore those individual amendments should not be endorsed; the other amendments however should be endorsed. Those EFRAG members have as a result exercised their right to dissent from recommending endorsement of some of the amendments. The amendments involved, and those members' reasoning for reaching the conclusions they have, are set out in the following paragraphs.

IFRS 8 – Disclosure of information about segment assets

- 2 Two EFRAG members (Ms Araceli Mora and Mr Carsten Zielke) believe that the amendment to IFRS 8 concerning the disclosure of information about segment assets should not be endorsed for use in the European Union and therefore dissent from EFRAG's decision to recommend its endorsement. These EFRAG members have reached this conclusion because they believe aspects of the amendment do not meet the endorsement criteria.
- 3 The amendment to IFRS 8 could result in a reduction in the segment information provided if the entity has material amounts of assets but does not regularly provide segment information about those assets to the chief operating decision maker. Ms Mora and Mr Zielke believe that this will result in the omission of relevant information from the financial statements and could render the segment information as a whole less understandable. As a result, in their view the amendment does not meet the criteria for endorsement in the EU. They note in particular that:
 - (a) empirical evidence indicates that the application of FASB's equivalent standard to IFRS 8, FAS 131 (which is also based on the chief operating decision maker principle), results in the omission of relevant information from the financial statements. Such an omission is to the detriment of users and has caused an increase in entities' cost of capital;
 - (b) even if one accepts the management approach on which IFRS 8 is based, there needs to be a limit on the application of the 'regularly provided to the chief operating decision maker' test if users are to be provided with useful segment information on all entities. In the view of these members, the lack of guidance in IFRS 8 as to which assets and liabilities should be disclosed has taken the application of that test too far because, without information about segment assets, the usefulness of other segment information is also affected; and
 - (c) the inconsistency identified by the IASB could have been addressed by amending IFRS 8 to make it clear that segment assets and liabilities are required to be disclosed in all cases and not just when the information is regularly provided to the chief operating decision maker.

IAS 39 – Scope exemption for business combination contracts

- 4 One EFRAG member (Mr Roberto Monachino) believes that the amendment to IAS 39 relating to the scope exemption for business combination contracts should not be endorsed for use in the European Union and therefore dissents from EFRAG's decision to recommend its endorsement. This EFRAG member has reached this conclusion because he believes aspects of the amendment do not meet the endorsement criteria.
- 5 There has been some uncertainty as to the scope of the exemption in IAS 39 for “contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date”. The amendment makes it clear that the exemption does not apply to:
 - (a) contracts between an acquirer and a vendor to buy or sell an acquiree at a future date that are not binding on one of the parties (ie contracts that meet the definition of a derivative option contract); or
 - (b) contracts to buy or sell an associate at a future date.
- 6 Mr Monachino is concerned about this clarification because he believes it changes the existing treatment of the contracts described in sub-paragraphs (a) and (b) above in a way that reduces the usefulness of the information provided. In particular, he notes that it means that forward contracts to buy or sell an acquiree at a future date are not within the scope of IAS 39 whilst option contracts are; in his view, this difference in accounting is not justified by the difference in the substance of the two contracts. As a result, he believes the amendment results in a lack of comparability, in information that is more difficult to understand than hitherto, and an accounting treatment for option contracts to buy or sell an acquiree at a future date that is not representationally faithful.