27 October 2011

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

Dear Sir/ Madam

IASB ED *Improvements to IFRSs*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft *Improvements to IFRSs* ('the ED'). This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive interpretations/amendments on the issues.

Our detailed comments on the ED are set out in the appendix to this letter. To summarize, we agree with most proposals in the ED, but EFRAG is concerned about the issues explained below.

IAS 1 Presentation of Financial Statements

EFRAG disagrees with the changes to IAS 1 to reflect the *Conceptual Framework for Financial Reporting 2010*. In our view, these changes do not meet the criteria to be addressed as part of the Annual Improvements Project. If the IASB intends to propose that the revised Conceptual Framework be reflected in existing standards, it should undertake a separate project to that purpose.

Amendments to IAS 32 Financial Instruments: Presentation

The purpose of these Amendments is to clarify that income tax relating to distributions to holders of an equity instrument and income tax relating to transaction costs of an equity transaction should be accounted for in accordance with IAS 12. EFRAG agrees with the proposal but believes that the IASB should address the inconsistency between paragraphs 52B, 58 and 61A of IAS 12. EFRAG is not convinced that the accounting for income tax on dividends, in situations like those described in paragraphs 52A and 52B of IAS 12 *Income Tax,* is consistent with the general principles underlying IAS 12.

In EFRAG's view, the general principle in IAS 12 is to classify income tax income (expense) based on the underlying transactions. EFRAG believes that the real issue lies with the inconsistency between the guidance in paragraph 52B and paragraph 58 and 61A of IAS 12. In paragraph 52B, dividend payments are deemed transactions that are related to profit and loss. While one might conclude under paragraphs 58 and 61A that dividends are an equity transactions with shareholders.

EFRAG believes that amending IAS 32, without addressing the inconsistency above, may not resolve the lack of clarity on how to account for income tax income (expense) on dividends. The IASB might wish to explain whether the recognition event that 'triggers' the income tax consequence is (1) the income from which the dividends are paid or (2) the declaration of dividends.

Amendments to IFRS1 First time adoption of International Financial Reporting Standards

EFRAG acknowledges that first-time adopters from jurisdictions moving to IFRSs may face not exactly the same first-time adoption issues as entities that have adopted IFRSs in earlier years. However, we are concerned that the continued addition of new exemptions will lead to increasing complexity of IFRS 1 and to potentially overlapping exemptions (e.g. the clarification of borrowing costs partially overlaps the "fair value as deemed cost" exemption for property, plant and equipment). Therefore, we recommend the Board to consider the longer term development of IFRS 1 both as other new standards are finalised and before proposing future exemptions.

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

Yours sincerely

Francoise Flores

EFRAG, Chairman

Appendix
EFRAG's detailed comments on the amendments proposed

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?

Issue 1: IFRS 1 – *First-time Adoption of IFRSs* – Clarification of borrowing costs exemption

EFRAG's response

EFRAG agrees with the IASB proposal to clarify the borrowing costs exemption, but is concerned about the increasing complexity of IFRS 1.

1 As EFRAG has stated in other comment letters on amendments to IFRS 1, the objective of this standard is to ensure that an entity's first IFRS financial statements contain high quality information that is transparent for users and comparable over all periods presented, provides a suitable starting point for accounting in accordance with IFRSs and can be generated at a cost that does not exceed the benefits.

2 For that reason, EFRAG agrees with the proposed clarification as it provides a reasonable approach for first-time adopters that reduces the cost of transition of IFRSs, while not significantly affecting the quality of the information published by those first-time adopters.

Issue 2: IFRS 1 – *First-time adoption of IFRSs* – Repeated application of IFRS 1

EFRAG's response

EFRAG agrees that an entity should apply IFRS 1 again if it resumes reporting under IFRSs after a period of not reporting under IFRSs.

3 As EFRAG has stated in other comment letters on amendments to IFRS 1, the objective of this standard is to ensure that an entity's first IFRS financial statements contain high quality information that is transparent for users and comparable over all periods presented, provides a suitable starting point for accounting in accordance with IFRSs and can be generated at a cost that does not exceed the benefits.

4 We believe that prohibiting repeated application of IFRS 1 could impose a significant burden on entities that resume reporting under IFRSs after a period of not reporting under IFRSs. Also, we note that this amendment merely clarifies the accounting treatment that we believe was always required by IFRS 1.

5 For these reasons, we agree with the proposal to amend IFRS 1 to state specifically that repeated application of IFRS 1 is required.

6 However, EFRAG would suggest that an entity applying IFRS 1 for the second time should be required to disclose that fact together with the reason why it stopped and now resumes reporting under IFRSs.

Issue 3: IAS 1 – *Presentation of Financial Statements* – Clarification of requirements for comparative information

EFRAG's response

EFRAG agrees with the clarification of the requirements for comparative information.

7 EFRAG agrees with the clarification that it is not necessary to reproduce in full the notes relating to the opening statement of financial position, but rather to provide the information required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, as such disclosure would merely repeat information already included in prior year's financial statements.

Issue 4: IAS 1 – *Presentation of Financial Statements* – Consistency with the updated *Conceptual Framework*

EFRAG's response

EFRAG believes that the amendments should not be addressed as part of the Annual Improvements Project, as changes made have far reaching pervasive effect on the scope of IFRS.

EFRAG also recommends that any potential impacts on existing standards of future changes in the Conceptual Framework be exposed as part of the exposure draft proposing the revision of the Conceptual Framework. We believe the IASB should update its due process handbook to reflect this requirement.

8 We note that the revised Conceptual Framework remains an unfinished work. We believe the consistency of IFRS would be strengthened by completing the update of the Conceptual Framework.

9 The amendments introduce wording that refers to the 'objective of financial reporting', which is a notion that is much broader than the 'objective of financial statements'. This potentially has a pervasive effect as it broadens the scope of the information that is to be included in IFRS financial statements. Therefore, we do not agree with this proposed amendment to IAS 1.

10 EFRAG believes that the amendments do not meet the criteria, in paragraph 65A of the IASB *Due Process Handbook*, to be addressed as part of the Annual Improvements Project. If the IASB intends to propose that the revised Conceptual Framework be reflected in existing standards, it should undertake a separate project to that purpose. We also believe that the IASB should consider amendments to existing standards, resulting from any future changes to its Conceptual Framework, at the time changes to the conceptual framework are proposed, to allow constituents to better understand the practical implications of the change at the concept level. This should be required as part of its normal due process.

Additional comments

11 As an aside, we note that the proposed amendments result in an incomplete update of IFRSs to reflect the revised Conceptual Framework. The proposed amendments to IAS 1 would only partially incorporate the revised Conceptual Framework. For example, the references in paragraphs 19, 20, 23 and 24 of IAS 1 to the 'objective of financial statements' are not consistent with the references to 'objective of financial reporting' in the new paragraph 9A. Furthermore, certain references remain in IFRSs to concepts that are not part of the revised Conceptual Framework. Paragraph 10(b) of IAS 8, for example, still refers to the concepts of 'relevance' and 'reliability', which are not part of the revised Conceptual Framework.

12 EFRAG understands that it is the Board's intention to include an effective date for this amendment to IAS 1, which was omitted in the Exposure Draft.

Issue 5: IAS 16 Property, Plant and Equipment – Clarification of accounting for servicing equipment

EFRAG's response

EFRAG agrees that the 'used only in connection with' condition in IAS 16 is too restrictive.

13 EFRAG notes that IAS 16 defines property, plant and equipment as 'tangible items that

(a) are held for use in the production or supply of goods and services, for rental to others, or for administrative purposes; and

(b) are expected to be used in more than one period'.

14 Inventories are defined in IAS 2 *Inventory* as 'assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production or such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services'.

15 Servicing equipment meets the definition of property, plant and equipment, but could also meet condition (c) in the definition of inventory. We agree with the Board that an entity should be required to take account of the intended use in the classification of servicing equipment.

16 EFRAG suggests also replacing 'to use' with 'to benefit from' in paragraph 8 of IAS 16 as this would be more closely aligned to the definition of an asset.

Issue 6: IAS 32 – *Financial Instruments: Presentation* – Tax effect of distributions to holders of equity instruments

EFRAG's response

Whilst EFRAG agrees with the proposed amendment, EFRAG believes that there is also an inconsistency between the guidance in paragraph 52B of IAS 12 and that in paragraphs 58 and 61A of IAS 12.

17 EFRAG thinks that the key issue is whether the recognition event that 'triggers' the income tax consequence is the income from which the dividends are paid or the declaration of dividends*.*

18 In EFRAG's view, the general principle in IAS 12 is to classify income tax income (expense) based on the underlying transaction. This general principle is set out in paragraphs 58 to 65A of IAS 12.

19 EFRAG believes that there is an inconsistency between the guidance in paragraph 52B of IAS 12 and that in paragraphs 58 and 61A of IAS 12:

(a) Paragraph 52B states that 'The income tax consequences of dividends are more directly linked to past transactions or events than to distributions to owners. Therefore, the <u>income tax consequences of dividends are recognised in profit or loss</u> (...)'

(b) Paragraph 58 states that 'Current and deferred tax shall be recognised as income or an expense and included in profit or loss for the period, <u>except to the extent that</u> the tax arises from: (a) a transaction or event which is recognised, in the same or a different period, outside profit or loss (...)' Paragraph 61A specifies further that the tax consequences may need to be recognised in other comprehensive income or directly in equity.

(c) Paragraph 61A of IAS 12 requires current tax and deferred tax to be <u>recognised outside profit or loss</u> if the tax relates to items that are recognised, in the same or a different period, outside profit or loss.

20 In other words, in paragraph 52B, dividend payments are deemed transactions that are related to profit or loss. While one might conclude under paragraphs 58 and 61A that dividends are an equity transaction with shareholders. EFRAG believes that amending IAS 32, without addressing the inconsistency above may not resolve the lack of clarity on how to account for income tax income (expense) on dividends.

Therefore, we believe that the IASB should also deal with this issue as part of the annual improvement.

21 EFRAG believes that the IASB should provide examples of when the income tax consequences of dividends would not be recognised in profit or loss for the period.

Issue 7: IAS 34 *Interim Financial Reporting* – Segment information for total assets

EFRAG's response

EFRAG agrees with the IASB proposal to amend the IAS 34 disclosure requirements regarding segment assets.

22 EFRAG agrees with the proposed amendment as it removes an apparent inconsistency.