EFRAG
European Financial Reporting Advisory Group

DRAFT COMMENT LETTER

Comments should be submitted by 30 September 2011 to Commentletters@efrag.org

XX XXXXX 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 summarise, we agree in principle with the proposals in the ED, although we sometimes raise some issues in detail or see a need for some rewording or for additional amendments to make the issue clearer. In particular we believe that the changes proposed to IAS 32 *Financial Instruments: Presentation* need to be extended as explained below.

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 new 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 PP&E). 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 Joaquin Sanchez-Horneros, Magdalena Zogala 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

Notes for EFRAG's constituents

1 *Paragraphs 27 and 28 of IAS 23* Borrowing Costs *contain the transitional provisions regarding borrowing costs. They provide for a prospective application to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after the effective date of transition into IFRSs. However, these transitional provisions are silent on the application to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is before the transition date.*

2 *Given the lack of guidance, constituents were split in their views about:*

   (a) whether the carrying amount of capitalised borrowing costs under previous GAAP should be eliminated at the transition date or retained ('grandfathered') at the transition date.

   (b) whether the subsequent capitalised costs should follow the requirements of IAS 23, or should remain accounted for in accordance with previous GAAP, even if inconsistent with IAS 23.

3 *In relation to (a) above, the IASB believes that paragraph 5 of IAS 8* Accounting Policies, Changes in Accounting Estimates and Errors *requires that prospective application (which is what paragraphs 27 and 28 of IAS 23 require) results in no adjustment at the date a new accounting policy is first applied. In other words, amounts determined in accordance with previous GAAP should be carried over to the statement of financial position at the date of transition rather than eliminated.*

4 *With respect to (b) above, accounting based on previous GAAP once the reporting entity has made the transition into IFRSs would reduce comparability and consistency.*

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.

5 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.

6 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.

7 EFRAG notes however that the reference to the 'borrowing cost component' in paragraph D23(a) is ambiguous in the sense that it is not clear whether it refers to borrowing cost as defined by IFRSs or those defined under an entity's previous GAAP. We believe that the standard should refer to the former, in order to prevent capitalisation of items that are clearly not borrowing costs under IFRSs.

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

Notes for EFRAG's constituents

8 *The IASB received a submission asking whether entities that had previously reported in accordance with IFRSs, but had stopped doing so, would be first-time adopters again if they resumed reporting under IFRSs. In particular, some had argued that this might not be the case because the IFRS for SMEs specifically prohibited an entity from being a first-time adopter of the IFRS for SMEs more than once.*

9 *The IASB agreed to amend IFRS 1 to state specifically that repeated application of IFRS 1 is required when an entity resumes reporting under IFRSs after a period of not reporting under IFRSs. In relation to SMEs, the Interpretations Committee decided to notify the Board that this question might need to be addressed as part of the post implementation review of the IFRS for SMEs.*

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.

10 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.

11 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.

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

13 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

Notes for EFRAG's constituents

14 *These amendments aim to address the diverging views, which arose as a result of the revision of IAS 1 in 2007, about the requirements for comparative information when a reporting entity provides financial information beyond the minimum comparative information requirements.*

EFRAG's response

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

15 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*

Notes for EFRAG's constituents

16 *The IASB considers that updating the objective of financial statements in IAS 1 to be consistent with the new Conceptual Framework is needed because the Conceptual Framework is effective immediately for the Board; therefore they will apply the new guidance in developing IFRSs. The Board believes that having different wording for the same concepts potentially creates confusion and translation problems.*

EFRAG's response

EFRAG agrees that the wording of the objective of financial statements in IAS 1 should be aligned with that in the Conceptual Framework.

17 EFRAG agrees that it is desirable for the IFRS literature to be based on consistent definitions of terms and objectives. However, we note that the new Conceptual

Framework remains an unfinished work and would like to see the IASB finalise the Conceptual Framework in order to prevent other inconsistencies from arising.

18 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

Notes for EFRAG's constituents

19 *The IASB was made aware of a possible inconsistency in the treatment of servicing equipment under IAS 16. In some jurisdictions, paragraph 8 of IAS 16 is interpreted to requiring servicing equipment to be treated as inventory if it is to be consumed during more than one period and does not relate to a specific item of PP&E. The Board proposes to clarify that it is not necessary that servicing equipment 'can be used only in connection with an item of property, plant and equipment' as this is too restrictive compared to the definition of PP&E.*

EFRAG's response

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

20 EFRAG notes that IAS 16 defines PP&E 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'.

21 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'.

22 Servicing equipment meets the definition of PP&E, 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.

23 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

Notes for EFRAG's constituents

24 *The IFRS Interpretations Committee (Interpretations Committee) discussed a conflict between paragraphs 52A and 52B of IAS 12* Income Taxes *and paragraph 35 of IAS 32* Financial Instruments: Presentation *regarding the accounting for income tax on distributions to holders of an equity instrument (dividends). The Interpretations Committee referred the issue to the IASB.*

25 *IAS 32 explicitly requires distributions to be accounted for in equity, net of any related income tax benefit. However, under IAS 12 it is not self-evident that tax consequences of dividends (recognised in equity) should be recognised in equity. Paragraph 52B of IAS 12 argues that income tax consequences of dividends are more directly linked to past transactions or events than to distributions to owners, therefore those tax consequences should be recognised in profit or loss, unless the circumstances described in paragraph 58 are met.*

26 *The IASB proposes to amend IAS 32 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'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.

27 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.

28 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.

29 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.

30 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.

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

Notes for EFRAG's constituents

31 *The 2009 Annual Improvements project amended paragraph 23 of IFRS 8 Operating Segments to clarify that a measure of segment assets should be disclosed only if that amount is regularly provided to the chief operating decision maker. However, a corresponding amendment to paragraph 16 (g)(iv) of IAS 34, which requires the same information in interim reports, was not made at the time.*

32 *The IASB proposes to clarify that disclosure of segment assets for a particular segment is required in interim financial reporting only when there has been a material change from the amount disclosed in the last annual financial statements for that segment and when the amounts are regularly provided to the chief operating decision maker.*

EFRAG's response

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

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