

This paper provides the technical advice from EFRAG FR TEG to the EFRAG FRB, following EFRAG FR TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG FRB. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG FRB are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

## **Annual Improvements to IFRS Accounting Standards—Volume 11**

### **Cover Note**

#### **Objective**

- 1 The objectives of the session are to:
  - (a) provide a summary of EFRAG TEG's recommendation in relation to the Draft Endorsement Advice ('DEA') on the IASB's Annual Improvements to IFRS Accounting Standards—Volume 11 ('the Amendments'); and
  - (b) approve the DEA as recommended by EFRAG FR TEG and contained in the agenda papers 11-02 and 11-03.

#### **Background of the IASB project**

- 2 On 18 July 2024 the IASB issued the Annual Improvements to IFRS Accounting Standards—Volume 11 ('the Amendments'). An Exposure Draft of the Amendments had been issued on 12 September 2023 ('the ED'). EFRAG provided its comment letter on that ED on 8 December 2023.
- 3 The objective of the Amendments is to provide limited changes that either clarify the wording in the amended IFRS Accounting Standard or correct relatively minor unintended consequences, oversights or conflicts between the requirements of the IFRS Accounting Standards. The following IFRS Accounting Standards and accompanying guidance will be affected by the Amendments:
  - (a) IFRS 1 *First-time Adoption of International Financial Reporting Standards* - hedge accounting by a first-time adopter;
  - (b) IFRS 7 *Financial Instruments: Disclosures* - gain or loss on derecognition;
  - (c) *Guidance on implementing IFRS 7*:
    - (i) Introduction;
    - (ii) Disclosure of deferred difference between fair value and transaction price;
    - (iii) Credit risk disclosures;
  - (d) IFRS 9 *Financial Instruments*:
    - (i) Derecognition of lease liabilities;

- (ii) Transaction price;
  - (e) IFRS 10 *Consolidated Financial Statements* - determination of a ‘de facto agent’; and
  - (f) IAS 7 *Statement of Cash Flows* - cost method.
- 4 The Amendments shall be applied for annual periods beginning on or after 1 January 2026, with earlier application permitted. If entities apply the Amendments earlier, they shall disclose that fact. Further, the amendment to IFRS 9 related to the derecognition of lease liabilities shall be applied to lease liabilities that are extinguished on or after the beginning of the annual reporting period in which the entity first applies that amendment (i.e., prospective application). All the other amendments shall be applied retrospectively.

#### EFRAG TEG recommendation

- 5 At the webcast meeting on 13 September, EFRAG FR TEG members acknowledged the concerns already expressed by EFRAG in its comment letter to the proposed amendments in December 2023 ([here](#)) and reflected in the DEA and the invitation to comment which are contained in **agenda papers 11-02 and 11-03**, respectively. However, they also highlighted the following:
- (a) The Amendments to IFRS 9 should not have relevant impact to current practice;
  - (b) The partial endorsement of the Amendments would increase the existing diversity in practice, would impact all the industries and would reduce comparability between European and no-EU IFRS-adopters; and
  - (c) The interaction between IFRS 9 and IFRS 16 should be addressed by the IASB through a specific standard-setting project.
- 6 Hence, the majority of the EFRAG FR TEG members agreed with recommending the DEA to the EFRAG FRB.
- 7 One EFRAG FR TEG member expressed a dissenting opinion for the reasons further explained in the **Appendix A** to this cover note.

#### EFRAG’s envisaged endorsement timetable

- 8 Under the agreement with the IASB to use their copyrighted material, the Amendments are published to EFRAG’s website ([here](#)) during the time necessary for EFRAG to complete its endorsement advice work. The Amendments will be removed from EFRAG’s website when the EC will publish the regulation adopting the Amendments in the EU Official Journal.
- 9 On 20 August 2024 EFRAG received from the European Commission the request for the endorsement advice on the Amendments.
- 10 Consistently with EFRAG FR TEG recommendation the EFRAG Secretariat proposes the following timetable:

EFRAG FR TEG approval of DEA to recommend to the EFRAG FRB	13 September 2024
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EFRAG FRB approval of DEA recommended by EFRAG FR TEG	8 October 2024
Public consultation on DEA	14 October to 22 November 2024 (around 35 days)
EFRAG FR TEG approval of Final Endorsement Advice (FEA) to recommend to the EFRAG FRB	2 December 2024
EFRAG FRB approval of FEA recommended by EFRAG FR TEG	11 December 2024
Publication of the Final Endorsement Advice	Week of 16 December 2024

**Questions for EFRAG FRB**

- 11 Does EFRAG FRB agree to approve the Draft Endorsement Advice (contained in agenda paper 11-02) and the Invitation to Comment (contained in agenda paper 11-03)?
- 12 Does EFRAG FRB agree with the proposed timetable summarised in paragraph 10 above?

**Next steps**

- 13 The EFRAG Secretariat to publish the DEA for public consultation.

**Agenda Papers**

- 14 In addition to this cover note, agenda papers for this session are:
  - (a) Agenda paper 11-02 – Annual Improvements Vol 11 - DEA - Letter to the EC; and
  - (b) Agenda paper 11 -03 – Annual Improvements Vol 11 - DEA - Invitation to comment.

**Appendix A - [Draft] Dissenting opinion of Pierre Phan Van Phi**

- 1 The annual amendment to IFRS 9 clarifies that when a lessee has determined that a lease liability has been extinguished applying IFRS 9, the lessee is required to recognise any resulting gain or loss in profit or loss in accordance with paragraph 3.3.3 of IFRS 9.
- 2 However, the amendment does not address how a lessee distinguishes between a lease modification as defined in IFRS 16 and an extinguishment of a lease liability in accordance with IFRS 9.
- 3 In its comment letter dated 8 December 2023<sup>1</sup>, EFRAG expressed significant concerns with respect to the technical merit of the proposed amendment and questioned whether it met the criteria of the IASB Due Process Handbook for an Annual Improvement. EFRAG therefore recommended the IASB to clarify the interaction between IFRS 9 and IFRS 16 and disagreed with the proposed amendment.
- 4 In my view, the IASB addressed none of the concerns raised by EFRAG. Instead, paragraph 2.45 of the Basis for Conclusions of the Annual Improvement to IFRS 9 explains that “the IASB concluded that clarifying that interaction between IFRS 9 and IFRS 16 is beyond the scope of an annual improvement”.
- 5 As a result, this amendment now creates confusion and an explicit conflict between IFRS 9 and IFRS 16 because it implies that certain lease modifications could be accounted for in accordance with IFRS 9 although they meet the definition of a lease modification in Appendix A of IFRS 16<sup>2</sup> and IFRS 16 is the more specific standard for leases. Prior to the amendment, lease experts generally held the view that there was no conflict as IFRS 9.3.3.1 was relevant for determining when a lease modification resulted in an extinguishment of the lease liability, but the offsetting entry to the derecognition was governed by IFRS 16 lease modification requirements resulting in an adjustment to the ROU, as illustrated in Example 19 of IFRS 16, rather than in a gain in profit or loss on derecognition.
- 6 Such conflict inevitably creates a policy choice which did not exist previously between IFRS 9 gain recognition and IFRS 16 ROU adjustment for rent concessions. This will create diversity as to whether and when to apply IFRS 9 to lease modifications.
- 7 If the amendment is not part of EU IFRS, European IFRS preparers will be able to continue prior practice (as described in paragraph 5 above) and still be compliant with IFRS as published.
- 8 For the reasons mentioned above, I do [currently] not recommend to EFRAG FRB to issue a positive endorsement advice on the Annual Improvements IFRS Accounting Standards - Volume 11.

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<sup>1</sup> See Appendix 1 for the relevant extract of EFRAG’s letter.

<sup>2</sup> “A change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).”

Appendix 1

Extract of EFRAG’s comment letter dated 8 December 2023 on the Exposure Draft Annual Improvements – Volume 11.

- 1 EFRAG notes that the proposed amendment arose from a submission to the IFRS Interpretation Committee (“IFRS IC”) relating to the lessee accounting for rent concession through a lease contract modification (please refer to the submission “Lessee accounting for lease payments forgiven (rent concession)” discussed in March 2023). During the discussion some IFRS IC members expressed concerns about the conclusion proposed by the IASB Staff related to IFRS 16 *Leases* but approved the conclusion related to IFRS 9. Therefore, EFRAG highlights that this proposed amendment would continue to not address the interaction between IFRS 9 and IFRS 16 when the extinguishment of a lease liability arises from a lease modification which only involve a change in the consideration paid.
- 2 As explained in Agenda paper 12A of the May 2023 IASB meeting, there is more than one way to read the requirements about how a lessee makes a corresponding adjustment when its lease liability has been extinguished and it removes that liability from its statement of financial position applying paragraph 3.3.1 of IFRS 9. The lessee could either:
  - (a) recognise the gain or loss in profit or loss applying paragraph 3.3.3 of IFRS 9, but is not required to do so because paragraph 2.1(b)(ii) of IFRS 9 does not refer to paragraph 3.3.3 of IFRS 9, or
  - (b) make a corresponding adjustment to its right-of-use asset recognised applying IFRS 16.
- 3 In EFRAG’s view, the proposed amendment will not resolve the conflict between IFRS 9 and IFRS 16 because a change in a lease arrangement that results (solely or together with other changes) in a lease liability (or a part thereof) being extinguished in accordance with IFRS 9 meets the definition of a lease modification in Appendix A of IFRS 16<sup>3</sup>.
- 4 EFRAG further notes that paragraph 46(b) of IFRS 16 requires that lessees to account for the remeasurement of a lease liability as a corresponding adjustment to the right-of-use asset, as illustrated in Illustrative Example 19 of IFRS 16.
- 5 Some are of the view, that applying IFRS 16 by precedence to IFRS 9 is consistent with applying the standard most relevant to a particular transaction (a lease) and such approach results in an accounting outcome faithfully representing the substance of a lease modification and closely aligning gain or loss recognition with a corresponding change in the lessee’s rights and obligations under the lease for the reasons explained in paragraph BC204 of IFRS 16.
- 6 EFRAG also notes that not all extinguishments of financial liabilities are accounted for as an immediate gain or loss in profit or loss. For example, any discount granted by a supplier of goods to a purchaser would normally be accounted for as a reduction in the cost of

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<sup>3</sup> “A change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).”

inventories by the purchaser rather than as a gain in profit or loss in accordance with paragraph 3.3.3 of IFRS 9.

- 7 In addition, in the view of some, the proposed amendment may even make the conflict more evident as many have interpreted paragraph 2.1(b)(ii) of IFRS 9 as currently worded to leave out intentionally (rather than being an oversight) any reference to paragraph 3.3.3 of IFRS 9: in their view, paragraph 3.3.1 of IFRS 9 is helpful to provide guidance as to when part of a lease liability is extinguished before the lease modification requirements of IFRS 16 are applied.
- 8 Finally, EFRAG also questions whether the proposed amendment meet the criteria set out in paragraphs 6.10 – 6.11 of the IASB Due Process Handbook because, in a number of stakeholders' view, it is not addressing an oversight or relatively minor unintended consequences.
- 9 Therefore, EFRAG recommends the IASB to clarify the interaction between IFRS 9 and IFRS 16 as part of a narrow-scope standard-setting project and does not recommend to amend paragraph 2.1(b)(ii) as part of the Annual Improvements – Volume 11.