EFRAG
European Financial Reporting Advisory Group

DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT ON ANNUAL IMPROVEMENTS TO IFRSs 2011-2013 CYCLE

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS

Comments should be sent to commentletters@efrag.org by 3 March 2014

EFRAG has been asked by the European Commission to provide it with advice and supporting material on the *Annual Improvements to IFRSs 2011-2013 Cycle* ('the Amendments'). In order to do that, EFRAG has been carrying out an assessment of the Amendments against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union ('the EU') and European Economic Area.

A summary of the Amendments is set out in Appendix 1.

Note to constituents

Annual Improvements to IFRSs 2011-2013 Cycle refer to IFRS 9 *Financial Instruments*, which has not yet been endorsed in the EU. These references to IFRS 9 are not addressed in this Draft Endorsement Advice and will be considered together with the related requirements in IFRS 9.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

EFRAG initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions on Appendix 2 and 3.

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

Organismo Italiano di Contabilità

(b) Are you a:

☐ Preparer ☐ User ☒ Other (please specify)

Standard setter

(c) Please provide a short description of your activity:

Issue of national accounting standard, participation in the issuing of IAS/IFRS and technical support to international organizations

(d) Country where you are located:

Italy

(e) Contact details including e-mail address:

presidenza@fondazioneoic.it

2 EFRAG's initial assessment of the Amendments is that they meet the technical criteria for endorsement. In other words, they are not contrary to the principle of true and fair view and they meet the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of the Amendments? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No, there aren't

3 EFRAG is also assessing the costs that are likely to arise for preparers and for users on implementation of the Amendments in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment of costs on implementation of the Amendments are set out in paragraphs 3, 8 and 12 of Appendix 3. To summarise, EFRAG's initial assessment of the Amendments to IAS 40 is:

(a) Users: the Amendments to IAS 40 are likely to result in cost savings that will outweigh any incremental costs incurred by users to incorporate the new requirements in their analysis when entities elect to apply them retrospectively; and

(b) Preparers: the Amendments to IAS 40 will not result in significantly increased costs to preparers (i.e. it is likely to be cost neutral).

Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

4 In addition, EFRAG is assessing the benefits that are likely to be derived from the Amendments. The results of the initial assessment of benefits are set out in paragraphs 3 and 16 of Appendix 3. To summarise, EFRAG's initial assessment is that the Amendments to IAS 40 *Investment Property* are likely to bring benefits to both users and preparers as:

(a) Users: the information resulting from the implementation of the Amendments to IAS 40 will increase comparability between entities and therefore will enhance users' analysis; and

(b) Preparers: the Amendments to IAS 40 will provide clarification to preparers regarding the process to select the accounting treatment that best represents the substance and the economics of the acquisition of an investment property with associated insignificant ancillary services.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

5 EFRAG's initial assessment is that the benefits to be derived from implementing the Amendments in the EU as described in paragraph 4 above are likely to outweigh the costs involved as described in paragraph 3 above.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

6 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on the Amendments.

Do you agree that there are no other factors?

☒ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

APPENDIX 1
A SUMMARY OF THE AMENDMENTS

1 The IASB has adopted an annual process to deal with non-urgent, but necessary, amendments to IFRSs (the annual improvements process). Issues dealt with in this process arise from matters raised by the International Financial Reporting Standards Interpretations Committee and suggestions from staff or practitioners, and focus on areas of inconsistency in IFRSs or where clarification of wording is required.

2 This Invitation to Comment deals with the amendments made by the International Accounting Standards Boards within the annual improvements project which were included in the standard published on 12 December 2013 *Annual Improvements to IFRSs 2011-2013 Cycle* (henceforth referred to as 'the Amendments') together with the related Basis for Conclusions. The Amendments were issued in draft form in November 2012 in the Exposure Draft ED/2012/2 *Annual Improvements to IFRSs 2011-2013 Cycle*.

3 This Invitation to Comment 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 are not part of IFRS as adopted by the EU. In addition, the amendments to IFRS 13 *Fair Value Measurement* refer to IFRS 9 *Financial Instruments*, which has not yet been endorsed in the EU.

4 Set out below is a description of each of the amendments made to current Standards.

IFRS 3 Business Combinations – Scope exceptions for joint ventures

5 The formation of a joint venture was excluded from the scope of IFRS 3 *Business Combinations* set out in paragraph 2(a) of that Standard. When IFRS 11 *Joint Arrangements* was issued, no consequential amendments were made to IFRS 3 *Business Combinations*. However, IFRS 11 had changed the definition of the term 'joint venture' from having a general meaning that included 'jointly controlled operations', 'jointly controlled assets' and 'jointly controlled entities', to meaning a specific type of joint arrangement, which does not include 'joint operations'.

6 In addition, there was uncertainty on whether the scope exclusion in paragraph 2(a) of IFRS 3 addressed (a) the accounting by the joint arrangements themselves in their financial statements only; or also (b) the accounting by the parties to the joint arrangement for their interests in the joint arrangement.

7 To address these concerns, the IASB amended paragraph 2(a) of IFRS 3 to clarify that:

(a) the formation of all types of joint arrangements are excluded from the scope of IFRS 3 by replacing 'joint venture' with 'joint arrangement'; and

(b) the only scope exclusion needed from the scope of IFRS 3 is the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.

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

8 The Amendments to IFRS 13 *Fair Value Measurement* clarify that IASB did not intend to exclude from the scope of the portfolio exception any contracts that are

within the scope of IAS 39 *Financial Instruments: Recognition and measurement*. Consequently, the IASB amended paragraph 52 of IFRS 13 to clarify that the portfolio exception applies to all contracts within the scope of, and accounted for in accordance with IAS 39 regardless of whether they meet the definitions of financial assets or financial liabilities as defined in IAS 32 *Financial Instruments: Presentation*.

IAS 40 Investment Property – Clarifying the interrelationship between IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property

9 The Amendments address the diversity in practice that exists regarding the scopes of IFRS 3 *Business Combinations* and IAS 40 *Investment Property*. Some believe that the standards are mutually exclusive, while others believe that an entity acquiring an investment property with ancillary services has to determine whether it also meets the definition of a business.

10 IAS 40 is amended to clarify that judgement is needed to determine whether the acquisition of investment property is the acquisition of an asset, a group of assets or a business combination in the scope of IFRS 3 and that this judgement is not based on paragraphs 7 to 14 of IAS 40 but on the guidance in IFRS 3. However, the distinction between investment property and owner-occupied property is based on paragraphs 7 to 14 of IAS 40.

11 The amendments to IAS 40 are to be applied prospectively to avoid the use of hindsight. However, an entity may elect to apply the amendments to individual transactions that occurred prior to the beginning of the first annual period occurring on or after the effective date only if the information needed is available to the entity.

Effective date

12 The Amendments apply for annual periods beginning on or after 1 July 2014, with earlier application permitted.

APPENDIX 2

EFRAG'S TECHNICAL ASSESSMENT OF THE AMENDMENTS AGAINST THE ENDORSEMENT CRITERIA

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 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 EU – 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 EU.

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 initial 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 initial 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 initial 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 initial assessment is that the Amendments to IAS 40 satisfy the understandability criterion in all material respects.

True and Fair

28 EFRAG's initial assessment is 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's initial assessment is that the Amendments satisfy the technical criteria for EU endorsement and EFRAG should therefore recommend their endorsement.

APPENDIX 3

EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENTS

General comments

1 EFRAG has also considered whether, and if so to what extent, implementing the amendments included in the Annual Improvements to IFRSs 2011-2013 Cycle ('the Amendments') in the EU might result in incremental costs for preparers and/or users, and whether those costs are likely to be exceeded by the benefits to be derived from their adoption.

2 EFRAG started its assessment of the costs and benefits of implementing all the changes to existing standards included in the Amendments by considering whether they were likely to be any measureable costs involved for preparers – including first-time adopters – or users in applying them.

3 EFRAG's initial assessment is that for the Amendments to IFRS 3 and IFRS 13 there will be a year one cost for preparers in reading and understanding the Amendments, but that cost will be insignificant. EFRAG's initial assessment is also that these amendments will not involve any significant change in costs for preparers or users and that the benefits to be derived from implementing these amendments are likely to outweigh the costs involved.

4 Based on EFRAG's assessment, the application of the Amendments to IAS 40 will have a cost and/or benefit impact on preparers and/or users of financial information because those amendments change current accounting practice; accordingly EFRAG has performed a specific assessment on the implementation of the Amendments to IAS 40.

Note to constituents

Annual Improvements to IFRSs 2011-2013 Cycle refer to IFRS 9 *Financial Instruments*, which has not yet been endorsed in the EU. These references to IFRS 9 are not addressed in this Draft Endorsement Advice and will be considered together with the related requirements in IFRS 9.

IAS 40 *Investment Property* – Clarifying the interrelationship between IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property

Cost for preparers

5 EFRAG has carried out an initial assessment of the cost implications for preparers resulting from the Amendments to IAS 40.

6 EFRAG believes that the initial and ongoing implementation of the Amendments to IAS 40 will not result in additional costs for preparers as these amendments only clarify how current requirements in existing Standards apply.

7 Regarding the transitional provisions, EFRAG believes that some costs could arise if entities elect to apply retrospectively the Amendments to IAS 40. However, EFRAG believes that these costs will not be significant as the amendments require that entities should have already collected all relevant information needed to apply the amended requirements in IAS 40.

8 Overall, EFRAG's initial assessment is that the Amendments to IAS 40 will not result in significantly increased costs to preparers (i.e. it is likely to be cost neutral).

Costs for users

9 EFRAG has carried out an initial assessment of the cost implications for users resulting from the Amendments to IAS 40.

10 EFRAG believes that users are already familiar both with the outcomes of both IAS 40 and IFRS 3.

11 Users might incur some costs when adapting their models if entities elect to apply retrospectively these amendments to past transactions and therefore they elect to apply the acquisition accounting in IFRS 3. However, we believe that users obtain relevant information in these circumstances as all assets and liabilities acquired in a business combination are measured at fair value and therefore it is likely that they will have cost savings in performing their analysis.

12 Overall, EFRAG's initial assessment is that the Amendments to IAS 40 are likely to result in cost savings that will outweigh any incremental costs incurred by users to incorporate the new requirements in their analysis when entities elect to apply them retrospectively.

Benefits for preparers and users

13 EFRAG has carried out an initial assessment of the benefits for users and preparers resulting from the Amendments to IAS 40.

14 In addition to the benefit highlighted in paragraph 11 above, in EFRAG's view, the Amendments to IAS 40 will reduce the divergence in practice. Therefore, users are likely to benefit, as the information resulting from the implementation of the Amendments to IAS 40 is more comparable between entities and therefore will enhance users' analysis.

15 In addition, the Amendments to IAS 40 will provide clarification to preparers and therefore they will ease the process to select the accounting treatment that best represents the substance and the economics of the acquisition of an investment property with associated insignificant ancillary services. Therefore, EFRAG believes that the Amendments to IAS 40 will result in benefits for preparers.

16 Therefore, overall, EFRAG's initial assessment is that both users and prepares are likely to benefit from the Amendments to IAS 40.

Conclusion

17 EFRAG's overall initial assessment is that the overall benefits of implementing the Amendments are likely to outweigh the costs involved.