

Draft Comment Letter

Comments should be submitted by 7 February 2014 to
commentletters@efrag.org

8 January 2014

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

Dear Sir/Madam,

Re: Exposure Draft *Annual Improvements to IFRSs 2012–2014 Cycle*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the exposure draft, *Annual Improvements to IFRSs 2012–2014 Cycle*, issued by the IASB on 11 December 2013 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

Our detailed comments and responses to the questions in the ED are set out in the Appendix. To summarise we agree with most proposals in the ED and with the objectives they are trying to achieve, but EFRAG is concerned about the proposed amendments to IAS 19 *Employee Benefits* for the reasons explained below.

EFRAG appreciates the responsiveness of the IASB in clarifying that it is the currency that the liabilities are denominated in that is important when determining the discount rate for post-employment benefit obligations rather than the country where they arise.

However, we note a number of circumstances in which it is unclear if the proposals would result in an outcome that is consistent with the objectives the IASB is trying to achieve (e.g. jurisdictions adopting stronger currencies of other countries, jurisdictions that have a deep market of high quality corporate bonds sharing a single currency with other countries, and interactions between local requirements on post-employment benefit liabilities and on plan assets).

Therefore, EFRAG believes that the IASB – before finalising these proposals – should explain the rationale in selecting and using a discount rate to measure post-employment benefit obligations so that constituents can exercise judgement in applying the requirements in paragraph 83 of IAS 19.

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

Yours faithfully,

Françoise Flores
EFRAG Chairman

APPENDIX

EFRA¹G's responses to the questions raised in the ED

Question 1 – Proposed amendment

Do you agree with the IASB's proposal to amend the Standards as described in the Exposure Draft?

If not, why and what alternative do you propose?

Question 2 – Transition provisions and effective date

Do you agree with the proposed transition 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 5 *Non-current Assets held for Sale and Discontinued Operations*: change of disposal method

Notes to constituents

- 1 *The IASB received a request to clarify the accounting for a change in a disposal plan where an entity decides not to sell a division but to spin it off and distribute it as a dividend in kind to its shareholders. Some constituents interpreted paragraph 26 of IFRS 5 Non-current Assets held for Sale and Discontinued Operations as requiring such a change to be considered as a change to a plan of sale that would be accounted for in accordance with paragraphs 26 to 29 of IFRS 5.*
- 2 *Paragraphs 26 to 29 of IFRS 5 require an entity to measure a non-current asset that ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale) at the lower of:*
 - (a) *its carrying amount before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale, and*
 - (b) *its recoverable amount at the date of the subsequent decision not to sell.*
- 3 *The entity should then include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale in profit or loss.*
- 4 *The IASB noted that IFRIC 17 Distribution of Non-cash Assets to Owners amended IFRS 5 by adding paragraphs 5A, 12A and 15A to provide guidance for held-for-distribution classification. However, these amendments did not provide guidance for when an entity reclassifies either an asset or a disposal group from held for sale to held for distribution (or vice versa), or when held-for-distribution accounting is discontinued.*
- 5 *To address the lack of guidance in IFRS 5, the IASB proposes to state that such a reclassification shall not be considered a change to a plan of sale and an entity should not follow the guidance in paragraphs 26 to 29 in IFRS 5 to account for this change. Accordingly, when these types of changes in plans occur, they should not be considered a new classification, but should instead lead to the continuation of the same classification, presentation and measurement requirements required for each type of disposal in IFRS 5.*

- 6 *The IASB proposes that the amendments to IFRS 5 be applied prospectively for annual periods beginning on or after 1 January 2016. Early application is permitted; however, entities should disclose that fact.*

EFRAG's response

EFRAG agrees with the proposals. However, we believe that these amendments should be applied retrospectively.

- 7 EFRAG agrees that this issue requires clarification and should be resolved as part of the annual improvement project.
- 8 EFRAG notes that the proposals are consistent with paragraph BC60 of IFRIC 17 *Distribution of Non-cash Assets to Owners*, which requires that the guidance in IFRS 5 on non-current assets (or disposal groups) classified as held for sale should also be applied to assets (or disposal groups) held for distribution to owners.
- 9 However, EFRAG believes that the IASB should make explicit in the proposed paragraph 26B that a change of a 'plan of sale' to a 'plan of distribution' (or vice versa) does not trigger any remeasurement provided that the criteria in paragraphs 6 to 12A of IFRS 5 are still met.
- 10 In addition, EFRAG believes that the proposed amendments should be applied retrospectively. In our view, if a change in plan had resulted in the remeasurement of either an asset or a disposal group in a previous period, an entity had already collected all the relevant information at the time of the change in the plan. Therefore, we believe that the risk of using hindsight in these circumstances is limited and outweighed by the benefit of having comparable information.

Issue 2: IFRS 7 *Financial Instruments- Disclosures*: servicing contracts

Notes to constituents

- 11 *The IASB received a request to clarify whether servicing contracts constitute continuing involvement for the purposes of applying the disclosure requirements in paragraphs 42E to 42H of IFRS 7 *Financial Instruments-Disclosure*. More specifically, the question was raised whether paragraph 42C(c) excludes servicing contracts from the scope of those disclosure requirements.*
- 12 *Paragraphs 42E to 42H of IFRS 7 require an entity to provide disclosures for all transferred financial assets that are not derecognised and for any continuing involvement in a transferred asset, existing at the reporting date, irrespective of when the related transfer transaction occurred.*
- 13 *The IASB proposes to add the following application guidance to IFRS 7 to make clear how paragraph 42C applies to servicing contracts:*
- (a) *The servicer's obligation to pass through to one or more entities the cash flows that it collects from the transferred financial asset is not in itself continuing involvement for the purposes of the disclosure requirements, because the activity of passing through cash flows does not in itself constitute an interest in the future performance of the transferred financial asset (proposed amendments to paragraph B30 of IFRS 7); and*
 - (b) *When an entity transfers a financial asset the entity may retain the right to service that financial asset for a fee that is included in, for example, a servicing contract. This type of servicing contract is generally continuing*

involvement for the purposes of the transfer disclosure requirements because, in most cases, the servicer has an interest in the future performance of the transferred financial assets as a result of that contract. That would be the case if the amount and/or timing of the servicing fee depend on the amount and/or timing of the cash flows collected from the transferred financial asset (proposed amendments to paragraph B30A of IFRS 7).

- 14 *The IASB proposes that the amendments be applied prospectively for annual periods beginning on or after 1 January 2016, with early application permitted.*

EFRAG's response

EFRAG agrees with the proposed amendments.

- 15 EFRAG agrees that this issue requires clarification and should be resolved as part of the annual improvement project.
- 16 In addition, EFRAG believes that the amendments improve the understandability of disclosures on servicing contracts and result in financial information that is relevant for users.
- 17 Finally, EFRAG agrees with the prospective application of these amendments as they reduce the risk of using hindsight in assessing fair values of assets and liabilities that could arise from servicing contracts.

Issue 3: IFRS 7 *Financial Instruments-Disclosure*: applicability of the amendments to IFRS 7 on offsetting financial assets and financial liabilities to condensed interim financial statements

Notes to constituents

- 18 *The IASB was asked to clarify the applicability of the amendments to IFRS 7 Disclosure–Offsetting Financial Assets and Financial Liabilities issued in December 2011 ('Amendments to IFRS 7') to condensed interim financial statements.*
- 19 *The effective date and transitional requirements set in in paragraph 44R of IFRS 7 required that the Amendments to IFRS 7 be applied 'for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods'.*
- 20 *There was uncertainty whether or not the disclosures requirements introduced by the Amendments to IFRS 7 should only be included in condensed interim financial statements prepared in the first year in which the disclosure requirements are effective.*
- 21 *The IASB proposes to amend paragraph 44R of IFRS 7 in order to clarify that the additional disclosures required by the Amendments to IFRS 7 are not required in interim periods after the year of initial application. However, the IASB noted in the basis for conclusions that the additional disclosure is required to be given in condensed interim financial statements prepared in accordance with IAS 34 Interim Financial Reporting when its inclusion would be required in accordance with the requirements of IAS 34.*
- 22 *The IASB proposes that these proposed amendments to IFRS 7 be applied retrospectively for annual periods beginning on or after 1 January 2016. Early application is permitted; however, entities should disclose that fact.*

EFRAG's response

EFRAG agrees with these proposed amendments.

- 23 EFRAG agrees that this issue required clarification and should be resolved as part of the annual improvement project.
- 24 Furthermore, EFRAG supports the proposed amendments as paragraph 44R of IFRS 7 results in burdensome disclosures that increase the cost of producing financial information while not being useful for users.
- 25 EFRAG also supports the retrospective application of these amendments and agrees with the basis for conclusions.

Issue 4: IAS 19 *Employee Benefits*: discount rate: regional market issue

Notes to constituents

- 26 *The IASB was asked to clarify the requirements of IAS 19 Employee Benefits to determine the discount rate in a regional market sharing the same currency (e.g. Eurozone). The issue arose because some think that the basket of high quality corporate bonds should be determined at a country level, and not at a currency level, because paragraph 83 of IAS 19 states that in countries where there is no deep market in such bonds, the market yields (at the end of the reporting period) on government bonds should be used.*
- 27 *The IASB proposes to amend paragraph 83 of IAS 19 in order to clarify that the high quality corporate bonds used to estimate the discount rate should be issued in the same currency in which the benefits are to be paid. Consequently, the depth of the market for high quality corporate bonds should be assessed at currency level.*
- 28 *The IASB proposes that the amendments to IAS 19 be applied retrospectively for annual periods beginning on or after 1 January 2016. Early application is permitted; however, entities should disclose that fact.*

EFRAG's response

EFRAG supports the IASB's intention to develop guidance dealing with countries where a high-quality corporate bond market does not exist and that use the same currency as other countries. However, we believe that the IASB – before finalising these proposals – should clarify the objectives underlying the selection and use of a discount rate in measuring post-employment benefit obligations.

- 29 EFRAG understands that paragraph 83 of IAS 19 *Employee Benefits* was developed at a time when the concept of jurisdiction was not significantly different from the one of currency. Therefore, we support the IASB's intention to develop enhanced guidance dealing with countries where a high-quality corporate bond market does not exist and that use the same currency as other countries (e.g. Eurozone).
- 30 In addition, EFRAG notes that the IFRS Interpretations Committee recently decided against issuing additional guidance on determining discount rates, as it would be too broad for them to address it in an efficient manner. They recommended that the IASB address the issue in its research project on discount rates. Notwithstanding, EFRAG supports that the IASB provides this clarification in the short-term without waiting for the outcomes of its research project on discount rates.

31 However, EFRAG believes that the IASB, before finalising these proposed amendments, should undertake a thorough analysis of the effects of its proposals:

- (a) to clarify the objectives of the discount rate used to measure post-employment benefit liabilities; and
- (b) to determine what an entity should do in the circumstances described in paragraphs 32 to 33 below.

In EFRAG's view, it is crucial that the IASB explains the rationale in selecting and using a discount rate to measure post-employment benefit obligations so that constituents can exercise judgement in applying the requirements in paragraph 83 of IAS 19.

32 Furthermore, EFRAG has a number of specific concerns regarding the proposed amendments that should be considered by the IASB:

- (a) The amendments could result in anomalous outcomes when a jurisdiction adopts a stronger currency (e.g. US Dollar) for trading purposes even if the fundamentals of these two jurisdictions are not comparable (e.g. Republic of Ecuador that uses US Dollar as currency);
- (b) It is unclear whether entities operating in jurisdictions where a deep high-quality corporate bond market exists (e.g. Germany) will be required to use blended rates defined at currency level (e.g. iBoxx) if they use the same currency as other countries in the same economic area (e.g. Eurozone); and
- (c) In some countries, pension plans need to invest in assets from that same country. In our view, using an internationally blended rate to discount the post-employment benefit liability while national yield curves to determine the fair value of the plan asset introduces artificial volatility in equity. We note that current mechanics in IAS 19 require that the return on plan assets, excluding amounts included in net interest on the net defined benefit liability, should be recognised in other comprehensive income.

33 Finally, while we understand the merits of using the same discount rate to achieve uniformity within economic areas using the same currency, EFRAG believes that the IASB should consider that other jurisdictional specific aspects might affect the selection of the discount rate.

Question to constituents

34 What is the additional guidance that should be considered in order to meet the objectives the IASB is trying to achieve with these proposed amendments?

35 Are you aware of any circumstance where these amendments will not result in meaningful outcomes?

36 Do you support the retrospective application of these amendments?

Issue 5: IAS 34 *Interim Financial Reporting*: disclosure of information 'elsewhere in the interim financial report'

Notes to constituents

37 *The IASB received a request to clarify the meaning of 'interim financial report', as defined in IAS 34 Interim Financial Reporting. The issue is whether 'elsewhere in the interim financial report', as described in paragraph 16A of IAS 34, means that*

the required information should be provided in the notes to the interim financial statements or elsewhere.

- 38 *The IASB proposes to amend paragraph 16A of IAS 34 to clarify the meaning of disclosure of information ‘elsewhere in the interim financial report’ and to require the inclusion of a cross-reference from the interim financial statements to the location of this information.*
- 39 *In the IASB’s view, if disclosures required by IAS 34 are presented outside the interim financial statements, those disclosures should be available to users of the interim financial statements on the same terms as the interim financial statements and at the same time.*
- 40 *The IASB proposes that the amendments to IAS 34 be applied retrospectively for annual periods beginning on or after 1 January 2016. Early application is permitted; however, entities should disclose that fact.*

EFRAG’s response

EFRAG agrees with these amendments.
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- 41 EFRAG agrees that this issue required clarification and should be resolved as part of the annual improvement project.
- 42 In addition, EFRAG supports these proposed amendments as we believe that they will improve the understandability of interim financial reporting and will result in information that is more useful to users.
- 43 However, EFRAG believes that the IASB should clarify what it means by ‘*on the same terms as the interim financial statements and at the same time*’, as this phrase is not well-understood. In particular, we note here that important jurisdictional differences exist in the requirements governing the review, publication and communication of interim financial information.
- 44 EFRAG also supports the retrospective application of these amendments.