EFRAG's Draft Letter to the European Commission Regarding Endorsement of Annual Improvements to IFRS Standards 2014-2016 Cycle

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[dd Month] 201X

Dear Mr Guersent

Adoption of *Annual Improvements to IFRS Standards 2014-2016 Cycle*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, EFRAG is pleased to provide its opinion on *Annual Improvements to IFRS Standards 2014-2016 Cycle* ('the Amendments'), which was issued by the IASB on 8 December 2016. An Exposure Draft of the Amendments was issued on 19 November 2015. EFRAG provided its comment letter on that Exposure Draft on 3 March 2016.

The objective of the Amendments is to address non-urgent but necessary issues discussed by the IASB during the project cycle that began in 2014 on areas of inconsistency in IFRS Standards or where clarification of wording is required.

The Amendments become effective for annual periods beginning on or after 1 January of 2017 and 1 January of 2018, with earlier application permitted for some amendments. A description is included in Appendix 1 to this letter.

In order to provide our endorsement advice as you have requested, we have first assessed whether the Amendments would meet the technical criteria for endorsement, in other words whether the Amendments would provide relevant, reliable, comparable and understandable information required to support economic decisions and the assessment of stewardship, lead to prudent accounting and are not contrary to the true and fair view principle. We have then assessed whether the Amendments would be conducive to the European public good. We provide our conclusions below.

Do the Amendments meet the IAS Regulation technical endorsement criteria?

EFRAG has concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, and raises no issues regarding prudent accounting. EFRAG has also assessed that the Amendments do not create any distortion in its interaction with other IFRS Standards and that all necessary disclosures are required.

Therefore EFRAG has concluded that the Amendments are not contrary to the true and fair view principle. EFRAG's reasoning is explained in Appendix 2 to this letter.

Are the Amendments conducive to the European public good?

In EFRAG's assessment of whether the Amendments would be conducive to the European public good, EFRAG has assessed whether the Amendments would improve financial reporting, would reach an acceptable cost-benefit trade-off, and whether the Amendments could affect economic growth.

EFRAG has assessed that the Amendments would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that adopting the Amendments is conducive to the European public good. EFRAG's reasoning is explained in Appendix 3 to this letter.

Our advice to the European Commission

As explained above, we have concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, raises no issues regarding prudent accounting, and that they are not contrary to the true and fair view principle. We have also concluded that the Amendments are conducive to the European public good. Therefore, we recommend the Amendments for endorsement without further delay.

We note that the amendment to IFRS 12 *Disclosure of Interests in Other Entities* applies retrospectively for annual periods beginning on or after 1 January 2017, despite being issued only in December 2016. The IASB determined that this very short implementation period is reasonable in this case because the amendment is clarifying in nature and entities would typically be required to apply it for the year ended 31 December 2017 at the earliest. EFRAG considers that the approach required by the amendment to IFRS 12 is already followed by many entities. EFRAG also agrees that entities that do not already follow this approach should have no particular difficulty in doing so by 31 December 2017 even if it is adopted in the EU only shortly before that date.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Jean-Paul Gauzès

President of the EFRAG Board

Appendix 1: Understanding the changes brought about by the Amendments

Background of the Amendments

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

2 The IASB published *Annual Improvements to IFRS Standards: 2014-2016 Cycle* (henceforth referred to as 'the Amendments') together with the related Basis for Conclusions on 8 December 2016. The Amendments were issued in draft form in November 2015 in the Exposure Draft ED/2015/10 *Annual Improvements to IFRSs: 2014-2016 Cycle*.

3 Set out below is a description of each of the Amendments made to current Standards.

The issues and how they have been addressed

Issue 1 - IFRS 1 First-time Adoption of International Financial Reporting Standards: Short-term exemptions for first time adopters

4 This Amendment proposes to delete the short-term exemptions in paragraphs E3–E7 of IFRS 1 *First-time Adoption of International Financial Reporting Standards*. These short-term exemptions are proposed to be deleted because the IASB noted that the relief provided in those paragraphs is no longer available, because it was relevant for reporting periods that have now passed. The IASB consequently concluded that the relief provided has now served its intended purpose.

Issue 2 – IFRS 12 Disclosure of Interests in Other Entities: Clarification of the scope of the disclosure requirements

5 This issue relates to the interactions of the disclosure requirements in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and the scope exception in paragraph B17 of IFRS 12 *Disclosure of Interests in Other Entities*.

6 Paragraph 5B of IFRS 5 states that the disclosure requirements in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations are in the scope of the Standard, and that the disclosure requirements in other IFRS Standards do not apply to such assets unless:

(a) other IFRS Standards require specific disclosures in respect of such assets; or

(b) other IFRS Standards require disclosures about the measurement of assets or liabilities within a disposal group that are outside the scope of the measurement requirements of IFRS 5.

7 IFRS 12 states that the disclosure requirements set out in paragraphs B10 – B16 do not apply to the interests within the scope of IFRS 12 that are classified as held for sale in accordance with IFRS 5.

8 The concern raised is that, in the light of the disclosure requirements in these two Standards, it is not clear whether the disclosure requirements of IFRS 12, other than those in paragraphs B10 – B16, should apply to such interests.

9 The Amendment clarifies that the disclosure requirements in IFRS 12 apply to any interests in other entities that are classified in accordance with IFRS 5 as held for sale or as held for distribution to owners, other than the disclosure requirements in paragraphs B10 – B16 of IFRS 12.

Issue 3: IAS 28 Investments in Associates and Joint Ventures: Measuring investees at fair value through profit or loss on an investment-by-investment basis

10 Before the IASB revised IAS 28 *Investments in Associates and Joint Ventures* in 2011, the fair value option for certain investments in an associate or a joint venture appeared as a scope exemption. That paragraph was moved to the body of IAS 28 as a result of the revision.

11 The IASB acknowledged that, before the revision in 2011, entities had an explicit option whereby they could choose to measure investees using the equity method, or the fair value option, on an investment-by-investment basis. However, after the revision, it was not clear whether the same option was still available.

12 The Amendments clarify that the election is available on an investment-by-investment basis, upon initial recognition of the asset in the scope of IAS 28.

When do the Amendments become effective?

Issue 1 - IFRS 1 First-time Adoption of International Financial Reporting Standards: Short-term exemptions for first time adopters

13 The Amendments to IFRS 1 apply for annual periods beginning on or after 1 January 2018.

Issue 2 – IFRS 12 Disclosure of Interests in Other Entities: Clarification of the scope of the disclosure requirements

14 The Amendments to IFRS 12 apply retrospectively for annual periods beginning on or after 1 January 2017.

Issue 3: IAS 28 Investments in Associates and Joint Venture: Measuring investees at fair value through profit or loss on an investment-by-investment basis

15 The Amendments to IAS 28 apply retrospectively for annual periods beginning on or after 1 January 2018. Earlier application is permitted; however, if entities apply the Amendments early, they should disclose that fact.

Appendix 2: EFRAG's technical assessment on the Amendments against the endorsement criteria

Does the accounting that results from the application of the Amendments meet the technical criteria for endorsement in the European Union?

16 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 (The IAS Regulation), in other words that the Amendments:

(a) are not contrary to the principle set out in Article 4 (3) of Council Directive 2013/34/EU (The Accounting Directive); 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.

17 Article 4(3) of the Accounting Directive provides that:

The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.

18 The IAS Regulation further clarifies that *'to adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of this Directive'* (Recital 9 of the IAS Regulation).

19 EFRAG's assessment as to whether the Amendments would not be contrary to the true and fair view principle has been performed against the European legal background summarised above.

20 In its assessment, EFRAG has considered the Amendments from the perspectives of both usefulness for decision-making and assessing the stewardship of management. EFRAG has concluded that the information resulting from the application of the Amendments is appropriate both for making decisions and assessing the stewardship of management.

21 EFRAG notes that the three subjects addressed by the Amendments are clarifications to or corrections of existing IFRS Standards:

(a) IFRS 1 *First-time Adoption of International Financial Reporting Standards*: Short-term exemptions for first time adopters;

(b) IFRS 12 *Disclosure of Interests in Other Entities*: Clarification of the scope of the disclosure requirements; and

(c) IAS 28 *Investments in Associates and Joint Venture*: Measuring investees at fair value through profit or loss on an investment-by-investment basis.

22 In EFRAG's view, the above amendments to existing IFRS Standards are straightforward and not controversial. They do not include any measurement requirements that could give rise to any concerns about relevance or reliability. By clarifying existing IFRS Standards in some – albeit small – way, they make the Standards easier to apply consistently, thus increasing understandability, without

raising any new concerns. As they are straightforward clarifications, they do not raise any issues about prudence.

23 In EFRAG's view, the above amendments to existing IFRS Standards do not involve changes to the existing accounting requirements or additional guidance on the implementation of those requirements which could affect the relevance, reliability, understandability, and comparability of financial information. Consequently they have been discussed collectively in this Appendix.

True and Fair View Principle

24 A Standard will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS Standards, it:

(a) does not lead to unavoidable distortions or significant omissions in the representation of that entity's assets, liabilities, financial position and profit or loss; and

(b) includes all disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss.

25 EFRAG has assessed that the Amendments do not create any negative interactions with other IFRS Standards. In particular, the Amendments introduce additional guidance for preparers and reduce complexity in the application of IFRS Standards. Accordingly, EFRAG has assessed that the Amendments do not lead to unavoidable distortions or significant omissions and therefore do not impede financial statements from providing a true and fair view.

26 EFRAG has concluded that the appropriate disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss are required.

27 As a result, EFRAG concludes that the application of the Amendments would not lead to information that would be contrary to the true and fair view principle.

Conclusion

28 Accordingly, for the reasons set out above, EFRAG's assessment is that the Amendments meet the technical requirements for EU endorsement as set out in the IAS Regulation.

Appendix 3: Assessing whether the Amendments are conducive to the European public good

Introduction

1 EFRAG considered whether it would be conducive to the European public good to adopt the Amendments. In addition to its assessment included in Appendix 2, EFRAG has considered a number of issues in order to identify any potential negative effects for the European economy on the application of the Amendments. In doing this, EFRAG considered:

(a) Whether the Amendments improve financial reporting. This requires a comparison of the Amendments with the existing requirements and how they fit into IFRS as a whole;

(b) The costs and benefits associated with the Amendments; and

(c) Whether the Amendments could have an adverse effect to the European economy, including financial stability and economic growth.

2 These assessments allow EFRAG to draw a conclusion as to whether the Amendments are likely to be conducive to the European public good. If the assessment concludes there is a net benefit, the Amendments will be conducive to the objectives of the IAS Regulation.

EFRAG's evaluation of whether the Amendments is likely to improve the quality of financial reporting

3 EFRAG notes that the Amendments are designed to clarify existing guidance for preparers, and remove certain obsolete requirements, and thereby reduce complexity in the application of IFRS Standards.

4 EFRAG has therefore concluded that the Amendments are likely to improve the quality of financial reporting.

EFRAG's initial analysis of the costs and benefits of the Amendments

5 EFRAG first considered the extent of the work. For some Standards or Interpretations, it might be necessary to carry out some extensive work, in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work.

6 EFRAG's initial assessment is that, with regard to costs for preparers, the Amendments would:

(a) Issue 1 Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*: create no costs for preparers as they no longer apply to new first-time adopters of IFRS Standards;

(b) Issue 2 Amendments to IFRS 12 *Disclosure of Interests in Other Entities*: create a one-off cost for preparers in reading and understanding the Amendments, but that cost will be insignificant. There will also be minor costs in gathering additional disclosure information; and

(c) Issue 3 Amendments to IAS 28 *Investments in Associates and Joint Venture*: create no costs for preparers as they provide clarity that an option is available.

7 EFRAG's initial assessment is that the Amendments will not involve any significant costs for users.

8 EFRAG's initial assessment is that the benefits in clarify to be derived from implementing the Amendments are likely to outweigh any costs involved for preparers or users.

Conclusion

9 EFRAG assesses that the Amendments will generally bring improved financial reporting when compared to current guidance. As such, their adoption is conducive to the European public good in that improved financial reporting improves transparency and assists in the assessment of management stewardship.

10 EFRAG has not identified that the Amendments could have any adverse effect to the European economy, including financial stability and economic growth.

11 Furthermore, EFRAG has considered whether there are any other factors that would mean adoption is not conducive to the public good and has not identified any such factors.

12 Having considered all relevant aspects, including the trade-off between the costs and benefits of implementing the Amendments, EFRAG assesses that adopting the Amendments is conducive to the European public good.