Annual Improvements to IFRS Standards 2018-2020 Cycle Issues Paper

Objective

1 The objective of the session is to present to EFRAG TEG the narrow-scope amendments that are expected to be included in the IASB's *Annual Improvements to IFRS Standards 2018-2020 Cycle* Exposure Draft ('ED') and seek initial input as a basis for preparing a draft comment letter.

Background

2 The IASB expects to issue the *Annual Improvements to IFRS Standards 2018-2020 Cycle* ED in second quarter 2019. The ED will address the following issues:

(a) Issue 1 - IFRS 1 *First-time Adoption of International Financial Reporting Standards:* Subsidiary as a first-time adopter;

(b) Issue 2 - IFRS 9 *Financial Instruments:* Fees included in the '10 per cent' test for derecognition;

(c) Issue 3 - Illustrative Examples accompanying IFRS 16 *Leases:* Lease incentives; and

(d) Issue 4 - IAS 41 *Agriculture:* Taxation in fair value measurements.

3 Relevant extracts from IFRS Standards are included in Appendix 1.

Issue 1 - IFRS 1 *First-time Adoption of International Financial Reporting Standards*: Subsidiary as a first-time adopter

Background of the issue

4 The issue relates to the accounting for the cumulative translation differences by a subsidiary that becomes a first-time adopter of IFRS Standards later than its parent. More precisely, whether the subsidiary is permitted to recognise cumulative translation differences at the amount that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs by applying paragraph D16(a) of IFRS 1.

Summary of IFRS IC and IASB discussions

5 This issue was discussed by the IFRS IC in March and September 2017 and the IFRS IC concluded that the exemption in paragraph D16(a) of IFRS 1 does not apply to cumulative translation differences.

6 Because paragraph D16(a) applies only to assets and liabilities and not to components of equity, the subsidiary would apply paragraphs D12–D13 of IFRS 1 to cumulative translation differences at its date of transition to IFRSs. Applying these paragraphs, the subsidiary would be required to keep two sets of records for cumulative translation differences. Consequently, based on the rationale in

paragraph BC60 of IFRS 1 the IASB proposes that measurement of the subsidiary's cumulative translation differences be subject to the exemption provided by paragraph D16(a).

7 The IASB concluded that extending this exemption to cumulative translation differences would reduce costs for first-time adopters without being detrimental to users of financial statements. This is because IFRS 1 already provides an exemption relating to cumulative translation differences and, thus, extending the exemption in paragraph D16(a) would not diminish the relevance of information reported by a subsidiary that become a first-time adopter later than its parent.

8 The IASB also considered, but decided against, extending the scope of the proposed amendment to other components of equity, such as:

(a) Remeasurement of pensions plans;

(b) Cash flow hedge reserve;

(c) Unrealised gain/loss on financial instruments; and

(d) Revaluation surplus for property plant and equipment.

9 The IASB concluded that extending the exemption in paragraph D16(a) to those other components of equity is unnecessary because, for example, no difference between the amounts reported by a subsidiary and its parent would arise for those components, or a subsidiary would be able to avoid any potential difference by applying (or not applying) some exemptions in IFRS 1.

Expected amendments to IFRS 1

10 The IASB proposes to require a subsidiary that applies paragraph D16(a) of IFRS 1 to measure cumulative translation differences using the amounts reported by the parent, based on the parent's date of transition to IFRSs.

11 This proposed amendment would also apply to an associate or joint venture that applies paragraph D16(a) of IFRS 1.

12 The IASB proposes to apply the amendment prospectively with earlier application permitted. If an entity applies the amendment early, it shall disclose that fact.

EFRAG Secretariat analysis

13 EFRAG Secretariat considers that extending the exemption, which currently applies to assets and liabilities of a subsidiary, to cumulative translation differences will increase the internal consistency of the IFRS 1, reduce costs for first-time adopters of IFRSs and will have no negative impact on users of financial statements.

14 The amendment will also allow a subsidiary to avoid keeping two sets of records based on different dates of transition to IFRSs and thus will reduce costs for preparers.

15 Based on the above, EFRAG Secretariat supports the IASB's proposal to extend the exemption in paragraph D16(a) of IFRS 1 to cumulative translation differences, as part of this Annual Improvements Cycle.

Questions for EFRAG TEG

16 Does EFRAG TEG agree with the EFRAG Secretariat analysis of Issue 1?

17 Does EFRAG TEG have any comment on the expected amendment to IFRS 1?

Issue 2 – IFRS 9 _Financial Instruments:_ Fees included in the '10 per cent' test for derecognition

Background of the issue

18 The issue relates to the clarification of the fees an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the original financial liability in accordance with the '10 per cent' test for derecognition in paragraph B3.3.6 of IFRS 9.

Summary of IFRS IC and IASB discussions

19 The IFRS IC received a request to clarify which fees and costs an entity includes in the '10 per cent' test for the purpose of derecognition of a financial liability. That is, whether it should include only fees paid to, or received from, the lender or also directly attributable third-party fees.

20 The IFRS IC discussed this issue in its March, September and November 2016 meetings and, having considered the responses to the tentative agenda decision, it recommended that the IASB propose an amendment to IFRS 9 to clarify the accounting by explaining that an entity should include only fees paid or received between the entity and the lender, including fees paid or received by either the entity or the lender on the other's behalf for the purposes of '10 per cent' test as part of the next Annual Improvements Cycle.

21 The IASB agreed with this proposal as in its view this clarification aligns with the objective of the '10 per cent' test to quantitatively assess the significance of any difference between the old and new contractual terms on the basis of the changes in the contractual cash flows between the borrower and lender. The IASB also considered that including cash flows paid to or received from parties other than the borrower and lender would go beyond assessing the difference between the old and new contractual terms.

Expected amendments to IFRS 9

22 Based on the IFRS IC conclusions, the IASB proposes to amend paragraph B3.3.6 and add paragraph B3.3.6A to clarify that a borrower includes only those fees paid or received between it and the lender, including fees paid or received by either the borrower or lender on the other's behalf.

23 The IASB proposes to apply the amendment prospectively with earlier application permitted. If an entity applies the amendment early, it shall disclose that fact.

EFRAG Secretariat analysis

24 EFRAG Secretariat considers that amending paragraph B3.3.6. will remove the confusion regarding the inclusion or not of the third-party fees in the assessment of the difference between the old and new contractual terms for the purposes of derecognition of financial liability. The proposed clarification will also avoid diversity in practice.

25 EFRAG notes the IASB's proposal to apply the amendment prospectively. The EFRAG Secretariat understands that the IASB's research indicates that the benefits of retrospective application will outweigh the costs and will not, in majority of cases, change the outcome of the '10 per cent' test.

26 Based on the above, EFRAG Secretariat supports the IASB's proposal to amend IFRS 9 as part of this Annual Improvements Cycle.

Questions for EFRAG TEG

27 Does EFRAG TEG agree with the EFRAG Secretariat analysis of Issue 2?

28 Does EFRAG TEG have any comment on the expected amendment to IFRS 9?

Issue 3 – Illustrative Examples accompanying IFRS 16 *Leases:* Lease incentives

Background of the issue

29 The issue relates to the potential confusion regarding the treatment of lease incentives resulting from Illustrative Example (IE) 13 accompanying IFRS 16. In particular, it is unclear why, in IE13, the lessee does not consider the reimbursement relating to leasehold improvements to be a lease incentive as defined in IFRS 16.

Summary of IASB discussions

30 The IASB highlighted that because IEs do not provide mandatory requirements, the requirements in IFRS 16 would prevail in case of any confusion or apparent conflict. However, to avoid any potential for confusion the IASB proposed to remove the illustration of payments from the lessor relating to leasehold improvements from IE 13.

Expected amendments to IFRS 16

31 The proposed amendment would remove from the example the illustration of the reimbursement of leasehold improvements by the lessor.

EFRAG Secretariat analysis

32 The EFRAG Secretariat notes that this amendment relates to IEs and IEs are not subject to endorsement in Europe. However, the EFRAG Secretariat considers that this would provide a useful clarification in the available guidance.

Questions for EFRAG TEG

33 Does EFRAG TEG agree with the EFRAG Secretariat analysis of the Issue 3?

34 Does EFRAG TEG have any comment on the expected amendment to IFRS 16?

Issue 4 - IAS 41 *Agriculture:* Taxation in fair value measurements

Background of the issue

35 In May 2008, the IASB amended IAS 41 to remove the requirement for entities to use a pre-tax rate to discount cash flows when measuring fair value. Nonetheless, at that time the IASB did not amend paragraph 22 of IAS 41 to delete the reference to cash flows for taxation. Consequently, when measuring fair value. IAS 41 requires an entity to use pre-tax cash flows, but does not require the use of a pre-tax rate to discount those cash flows.

Summary of IFRS IC and IASB discussions

1 The IFRS IC received a request to remove the reference to cash flows for taxation from paragraph 22 of IAS 41.

2 Paragraph 22 currently states “An entity does not include any cash flows for financing the assets, taxation, or re-establishing biological assets after harvest (for example, the cost of replanting trees in a plantation forest after harvest).”

3 This was discussed during the IFRS IC September 2017 meeting and supported on the following grounds:

(a) The IASB’s intention in amending IAS 41 in 2008 was to permit entities to include taxation cash flows in measuring fair value. Removing 'taxation' from paragraph 22 is consistent with that intent.

(b) Such an amendment would also align the requirements in IAS 41 on fair value measurement with those in IFRS 13 *Fair Value Measurement*. IFRS 13 neither prescribes the use of a single present value technique nor limits the use of present value techniques to measure fair value to only those discussed in that Standard. Depending on the particular facts and circumstances, in applying IFRS 13 an entity might measure fair value by discounting after-tax cash flows or pre-tax cash flows.

Expected amendments to IFRS 16

4 The IASB proposes to remove the requirement in paragraph 22 of IAS 41 to exclude cash flows for taxation when measuring fair value in applying IAS 41.

5 The IASB proposes to apply the amendment prospectively with earlier application permitted. If an entity applies the amendment early, it shall disclose that fact.

EFRAG Secretariat analysis

6 EFRAG Secretariat supports the IASB's proposal to remove the requirement in paragraph 22 of IAS 41 to exclude cash flows for taxation when measuring fair value applying IAS 41, as part of the Annual Improvements Cycle.

7 EFRAG Secretariat considers that it will bring clarity to the fair value requirements of IAS 41 and will also make IAS 41 consistent with the requirements of IFRS 13.

8 EFRAG Secretariat supports the IASB's proposal on prospective application of the amendment with an earlier application permitted and the IASB reasoning that retrospective application will bring little or no added value to the users of financial statements and will be costly for preparers.

Questions for EFRAG TEG

9 Does EFRAG TEG agree with the EFRAG Secretariat analysis of the Issue 4?

10 Does EFRAG TEG have any comment on the expected amendment to IAS 41?

Appendix I: Relevant paragraphs in the IFRS Standards

IFRS 1

Paragraph D16(a)

1 If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its financial statements, measure its assets and liabilities at either:

2 (a) the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary…

Paragraph D12

3 IAS 21 requires an entity:

(a) to recognise some translation differences in other comprehensive income and accumulate these in a separate component of equity; and

(b) on disposal of a foreign operation, to reclassify the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) from equity to profit or loss as part of the gain or loss on disposal.

Paragraph D13

4 However, a first-time adopter need not comply with these requirements for cumulative translation differences that existed at the date of transition to IFRSs. If a first-time adopter uses this exemption:

(a) the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to IFRSs; and

(b) the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to IFRSs and shall include later translation differences.

Paragraph BC60 of the Basis for Conclusions

5 In developing ED 1, the Board concluded that a requirement to keep two parallel sets of records would be burdensome and not be beneficial to users. Therefore, ED 1 proposed that a subsidiary would not be treated as a first-time adopter for recognition and measurement purposes if the subsidiary was consolidated in IFRS financial statements for the previous period and all owners of the minority interests consented.

IFRS 9

Paragraph B3.3.2

1 If an issuer of a debt instrument repurchases that instrument, the debt is extinguished even if the issuer is a market maker in that instrument or intends to resell it in the near term.

Paragraph B3.3.6

2 For the purpose of paragraph 3.3.2, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the

extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

IFRS 16

Extracts from IE13

1 Lessee enters into a 10-year lease of a floor of a building, with an option to extend for five years. Lease payments are CU50,000 per year during the initial term and CU55,000 per year during the optional period, all payable at the beginning of each year. To obtain the lease, Lessee incurs initial direct costs of CU20,000, of which CU15,000 relates to a payment to a former tenant occupying that floor of the building and CU5,000 relates to a commission paid to the real estate agent that arranged the lease. **As an incentive to Lessee for entering into the lease, Lessor agrees to reimburse to Lessee the real estate commission of CU5,000 and Lessee's leasehold improvements of CU7,000.**

2 At the commencement date, Lessee makes the lease payment for the first year, incurs initial direct costs, receives lease incentives from Lessor and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognises assets and liabilities in relation to the lease as follows:

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000
Right-of-use asset	CU20,000	
Cash (initial direct costs)		CU20,000
Cash (lease incentive)	CU5,000	
Right-of-use asset		CU5,000

Lessee accounts for the reimbursement of leasehold improvements from Lessor applying other relevant Standards and not as a lease incentive applying IFRS 16. This is because costs incurred on leasehold improvements by Lessee are not included within the cost of the right-of-use asset.

IAS 41

Paragraph 22

3 An entity does not include any cash flows for financing the assets, taxation, or re-establishing biological assets after harvest (for example, the cost of replanting trees in a plantation forest after harvest).

Paragraph BC6 of the Basis for Conclusions

4 The Board noted that a willing buyer would factor into the amount that it would be willing to pay the seller to acquire an asset (or would receive to assume a liability) all incremental cash flows that would benefit that buyer. Those incremental cash flows would be reduced by expected income tax payments using appropriate tax rates (i.e. the tax rate of a market participant buyer). Accordingly, fair value takes into account future income taxes that a market participant purchasing the asset (or assuming the liability) would be expected to pay (or to receive), without regard to an entity's specific tax situation.