Comment Letter

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

XX December 2023

Dear Mr Barckow,

Re: Exposure Draft *Annual Improvements—Volume 11*

On behalf of EFRAG, I am writing to comment on the Exposure Draft IASB/AI/ED/2023/1 *Annual Improvements - Volume 11,* issued by the IASB on 12 September 2023 (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 Standards in the European Union and European Economic Area.

EFRAG welcomes the package of the annual improvements included in the ED, which mainly consists of limited changes that either clarify the wording in an IFRS Accounting Standard or correct relatively minor unintended consequences, oversights or conflicts between the requirements of the IFRS Accounting Standards.

EFRAG agrees with the majority of the proposed amendments and considers that they would help to improve consistent application and understandability of the IFRS Accounting Standards.

However, 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.

Regarding the proposed amendment to IFRS 10 on de facto agents, EFRAG recommends the IASB to reconsider whether a look-up approach (i.e., including those that direct the activities of the investor) could ever be used for assessing if a party is a de facto agent for the purposes of the entity's consolidated financial statements.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

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

Yours sincerely,

Wolf Klinz,

President of the EFRAG FRB

Appendix - EFRAG’s responses to the questions raised in the ED

Proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Hedge accounting by a first-time adopter

> Do you agree with the IASB’s proposals to amend the IFRS Accounting Standards and accompanying guidance in the manner described in this Exposure Draft?
>
> If not, why not? If you disagree with these proposals, please explain what you would suggest instead and why.

EFRAG’s response

1 EFRAG believes that replacing ‘conditions’ with ‘qualifying criteria’ would clarify the wording in paragraph B6 of IFRS 1 *First-time Adoption of International Financial Reporting Standards* and correct a prior minor oversight. In addition, adding cross-references to the requirements in IFRS 9 Financial Instruments in paragraph B5 and B6 would improve navigability and accessibility of IFRS Accounting Standards.

2 Furthermore, EFRAG highlights that such amendments would maintain consistency between the requirements of IFRS 1 and IFRS 9 and would not constitute a new (or change an existing) principle or requirement.

3 Therefore, EFRAG agrees with the IASB proposal to amend paragraphs B5–B6 of IFRS 1 by replacing the word ‘conditions’ with ‘qualifying criteria’ and adding cross-references to paragraphs 6.4.1(a)–(c) of IFRS 9.

Proposed amendments to IFRS 7 *Financial Instruments: Disclosures*

Gain or loss on derecognition

> Do you agree with the IASB’s proposals to amend the IFRS Accounting Standards and accompanying guidance in the manner described in this Exposure Draft?
>
> If not, why not? If you disagree with these proposals, please explain what you would suggest instead and why.

EFRAG’s response

4 EFRAG agrees with the IASB’s proposal to amend paragraph B38 of IFRS 7 *Financial Instruments: Disclosures* to replace the reference to paragraph 27A of IFRS 7 with a reference to paragraphs 72–73 of IFRS 13 *Fair Value Measurement*, which effectively replaced the requirements in paragraph 27A of IFRS 7 moved to IFRS 13 in 2011.

5 Furthermore, EFRAG supports the IASB’s proposal to align the wording in paragraph B38 of IFRS 7 with the wording in paragraph 72 of IFRS 13 which would improve consistency between IFRS Accounting Standards.

Proposed amendments to Guidance on implementing IFRS 7

Amendments to Guidance on implementing IFRS 7

> Do you agree with the IASB’s proposals to amend the IFRS Accounting Standards and accompanying guidance in the manner described in this Exposure Draft?
>
> If not, why not? If you disagree with these proposals, please explain what you would suggest instead and why.

EFRAG's response

6 EFRAG notes that implementation guidance is not a part of the IFRS Accounting Standards and, hence, is not endorsed in the EU.

7 EFRAG welcomes the proposed amendments to paragraph IG14 as they would align the wording of that paragraph with the wording in paragraph 28 of IFRS 7 and consequently with the concepts and terminology used in IFRS 9 and IFRS 13, to which this implementation guidance refers to.

8 EFRAG further notes that paragraph 35M(c) of IFRS 7 requires separate disclosures of quantitative and qualitative information about amounts arising from expected credit losses for financial assets that are purchased or originated credit-impaired ('POCI'). Paragraphs IG20B and IG20C do not include examples of disclosures for POCI assets required by paragraph 35M(c) of IFRS 7. However, this fact is only specifically stated in the paragraph IG20B. Nevertheless, EFRAG notes that paragraph IG20A already states that *"these illustrations do not address all possible ways of applying the disclosure requirements"*.

9 EFRAG questions the necessity to state in every example all the requirements it does not address. Nevertheless, on balance, EFRAG agrees with the IASB proposal to make a generic statement in paragraph IG1, *that "the guidance does not illustrate all the requirements in IFRS 7..."* which is reinforced by paragraph IG20A. EFRAG also agrees with a minor change proposed to the paragraph IG20B.

EFRAG welcomes the proposed amendments to paragraph IG14 as it would align the wording of that paragraph with the wording used in paragraph 28 of IFRS 7 (and consequently with the concepts and terminology used in IFRS 9 and IFRS 13), to which this implementation guidance refers to.

Proposed amendments to IFRS 9 *Financial Instruments*

Derecognition of lease liabilities

Do you agree with the IASB's proposals to amend the IFRS Accounting Standards and accompanying guidance in the manner described in this Exposure Draft? If not, why not? If you disagree with these proposals, please explain what you would suggest instead and why.

EFRAG's response

10 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.

11 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.

12 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[1].

13 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, with the only exception of lease modifications that result in a full or partial termination of a lease as illustrated in Illustrative Example 19 of IFRS 16.

14 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.

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

16 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.

17 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.

18 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.

Proposed amendments to IFRS 9 *Financial Instruments*

Transaction price

Do you agree with the IASB's proposals to amend the IFRS Accounting Standards and accompanying guidance in the manner described in this Exposure Draft?

[1] 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).

If not, why not? If you disagree with these proposals, please explain what you would suggest instead and why.

EFRAG's response

19 EFRAG notes that this issue, even if not included in the EFRAG draft comment letter in response to the IASB's Request for Information - *Post-Implementation Review of IFRS 15 Revenue from Contracts with Customers* ("PIR of IFRS 15") because it qualified as an issue with low priority, has also been raised by some auditors in the context of the PIR of IFRS 15 when discussing the interaction with other IFRS Accounting Standards. In particular, it was highlighted that IFRS 9 does not seem to envisage scenarios in which the amount of a receivable may differ from the transaction price that are instead envisaged by IFRS 15 in case of variable consideration, rebate or refund (as showed in the Illustrative Example 40 accompanying IFRS 15).

20 Therefore, EFRAG agrees with the proposed amendments to paragraph 5.1.3 and Appendix A of IFRS 9 by removing the reference to 'transaction price' as defined in IFRS 15 as it would avoid confusion and improve consistency between IFRS 9 and IFRS 15 when referring to transaction price related to revenue from contracts with customers.

Proposed amendments to IFRS 10 *Consolidated Financial Statements*

Determination of a 'de facto agent'

Do you agree with the IASB's proposals to amend the IFRS Accounting Standards and accompanying guidance in the manner described in this Exposure Draft? If not, why not? If you disagree with these proposals, please explain what you would suggest instead and why.

EFRAG's response

21 EFRAG welcomes the IASB intention to remove the inconsistency between the requirement to use judgement in paragraph B73 and paragraph B74 by amending paragraph B74 by using less conclusive language.

22 EFRAG acknowledges that the proposed amendments to paragraph B74 of IFRS 10 *Consolidated Financial Statements* leaves unsolved a number of issues in the assessment of de facto agent. For example, it does not explain why it would be appropriate to include consideration of shareholdings in an investee by the controlling shareholder of an investor when assessing the investor's influence over an investee.

23 EFRAG has been informed that this is a concern that many constituents (including preparers, auditors and enforcers) share in practice. In these constituents' view, the IASB should clarify that a top-down approach should apply to assess control and consequently that it should not be possible to consider the ultimate parent of an investor as an agent for the investor.

24 However, EFRAG notes that the purpose of the proposed narrow scope amendment is not to change how the assessment of control is performed, which goes beyond the scope of *Annual Improvements* project, but to allow more flexibility in using judgement when considering the nature of a relationship with other parties.

25 With this in mind, on balance, EFRAG agrees with the proposed amendments to paragraph B74 of IFRS 10 but recommends the IASB to reconsider whether, in assessing if a party is a de facto agent of an entity, the entity needs to look upward to the powers held by its parent over that party. This would seem to depart from the well-established principle of considering only the powers and abilities to direct other parties held by an entity, i.e. downward look, in assessing de facto agents or, in general, control over other parties for the purposes of the entity's consolidated financial statements.

Proposed amendments to IAS 7 *Statement of Cash Flows*

Cost method

Do you agree with the IASB's proposals to amend the IFRS Accounting Standards and accompanying guidance in the manner described in this Exposure Draft? If not, why not? If you disagree with these proposals, please explain what you would suggest instead and why.

EFRAG's response

26 EFRAG agrees with the IASB's proposal to amend paragraph 37 of IAS 7 *Statement of Cash Flows* to replace the term 'cost method' with 'at cost' as it would correct a prior minor oversight and ensure the consistent use of the terminology.