



EUROPEAN COMMISSION

Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE

Accounting

Brussels, 22 July 2008

MARKT F3 D(2008)

Endorsement of *Improvements to IFRSs*

Introduction, background and conclusions

Attachment 1: Effect study prepared by the European Financial Reporting Advisory Group (EFRAG)

Attachment 2: Endorsement advice prepared by EFRAG

1. EFFECT STUDY

The European Commission has agreed with the European Parliament that Effect Studies should be prepared for new accounting standards and interpretations up for endorsement in the European Union (EU). The Commission Services together with the European Financial Reporting Advisory Group (EFRAG) prepare these studies containing description of the accounting issues involved, results from stakeholder consultations as well as analysis of effects of using the new accounting rules in the EU.

EFRAG has prepared an Effect Study for *Improvements to IFRSs* (attached). As the EFRAG Effect Study refers to the Endorsement Advice, we also included it in attachments.

This cover note contains background information, comments and a conclusion by the Commission Services.

2. BACKGROUND ON IMPROVEMENTS TO IFRSs

The IASB annual improvement process

The IASB has adopted an annual process to deal with non-urgent but necessary amendments to IFRS (the "annual improvement process"). The issues dealt with in the annual improvement process arise from matters raised by IFRIC and suggestions from staff or practitioners, and focus on areas of inconsistency in IFRSs or where clarification of wording is required. The amendments to different standards are dealt with in a single document with the intention to streamline the standard-setting process.

The 2008 improvements

The work was initiated in July 2006 and concluded on May 2008 with the publication of the improvement document. There is currently another project going on for the period 2007-2009 that will result in new amendments and improvements to IFRS.

The IASB published an Exposure Draft (ED) in October 2007 which included more amendments than those included in the final document (42 amendments in the ED compared to 35 in the final document). Having considered the comments, the IASB decided to postpone some of the proposals until further analysis could be completed¹. One of the proposals that were taken out from the final document was the issue of IFRS *branding* (Statement of compliance with IFRSs).

How is the IASB document structured and what issues are dealt with?

The document presented by the IASB is divided into two parts. Part I of the document contains amendments that result in accounting changes for presentation, recognition or measurement purposes. Part II of the document relates to changes in terminology or to amendments of an editorial nature, which the Board expects to have no or minimal effect on accounting.

¹ The IASB also decided to issue separately an amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

The following table shows the amendments included in the Part I and Part II of the document.

PART I	
IFRS	SUBJECT OF AMENDMENT
IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i>	Plan to sell the controlling interest in a subsidiary
IAS 1 <i>Presentation of Financial Statements</i>	Current/non-current classification of derivatives
IAS 16 <i>Property, Plant and Equipment</i>	Recoverable amount
	Sale of assets held for rental
IAS 19 <i>Employee Benefits</i>	Curtailments and negative past service cost
	Plan administration costs
	Replacement of term 'fall due'
	Guidance on contingent liabilities
IAS 20 <i>Accounting for Government Grants and Disclosure of Government Assistance</i>	Government loans with a below-market rate of interest
IAS 23 <i>Borrowing Costs</i>	Components of borrowing costs
IAS 27 <i>Consolidated and Separate Financial Statements</i>	Measurement of subsidiary held for sale in separate financial statements
IAS 28 <i>Investments in Associates</i>	Required disclosures when investments in associates are accounted for at fair value through profit or loss
	Impairment of investment in associate
IAS 31 <i>Interests in Joint Ventures</i>	Required disclosures when interests in jointly controlled entities are accounted for at fair value through profit or loss
IAS 29 <i>Financial Reporting in Hyperinflationary Economies</i> ²	Description of measurement basis in financial statements
IAS 36 <i>Impairment of Assets</i>	Disclosure of estimates used to determine recoverable Amount
IAS 38 <i>Intangible Assets</i>	Advertising and promotional activities
	Unit of production method of amortisation
IAS 39 <i>Financial Instruments: Recognition and Measurement</i>	Reclassification of derivatives into or out of the classification of at fair value through profit or loss
	Designating and documenting hedges at the segment level
	Applicable effective interest rate on cessation of fair value hedge accounting
IAS 40 <i>Investment Property</i>	Property under construction or development for future use as investment property
IAS 41 <i>Agriculture</i>	Discount rate for fair value calculations
	Additional biological transformation
PART II	
IFRS	SUBJECT OF AMENDMENT
IFRS 7 <i>Financial Instruments: Disclosures</i>	Presentation of finance costs
IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>	Status of implementation guidance
IAS 10 <i>Events after the Reporting Period</i>	Dividends declared after the end of the reporting period
IAS 18 <i>Revenue</i>	Costs of originating a loan
IAS 20 <i>Accounting for Government Grants and Disclosure of Government Assistance</i>	Consistency of terminology with other IFRSs
IAS 29 <i>Financial Reporting in Hyperinflationary Economies</i>	Consistency of terminology with other IFRSs
IAS 34 <i>Interim Financial Reporting</i>	Earnings per share disclosures in interim financial reports
IAS 40 <i>Investment Property</i>	Consistency of terminology with IAS 8
	Investment property held under lease
IAS 41 <i>Agriculture</i>	Examples of agricultural produce and products
	Point-of-sale costs

² This amendment has been considered by EFRAG together with other amendments to IAS 29 in the analysis of part II of the Document

Almost all of the amendments included in the part I of the document become effective for annual periods beginning on or after 1 January 2009³. All amendments included in part II of the document have as the effective date of application 1 January 2009.

IASB and EFRAG consultations

The IASB carried out a consultation according to its due process and received 75 comment letters to the Exposure Draft published October 2007. Most of the respondents agreed with the objective of the annual improvement process, basically to address non-urgent, necessary but minor amendments that are improvements to IFRS. However, many respondents questioned if the amendments proposed meet that objective. To address these concerns, the IASB decided to revise some of the amendments and to exclude some of them from the final document. The IASB published the final document in May 2008.

Commentators to the EFRAG consultation fully agreed with EFRAG's assessment of the cost involved for users and preparers, and mostly also with the EFRAG's analysis of the benefits associated with implementing the amendments. The EFRAG User Panel also discussed potential costs and benefits for users and confirmed EFRAG's assessment.

3. EFFECT ANALYSIS

EFRAG's assessment of the importance of the different accounting issues included in the improvement package

In order to structure its analysis, EFRAG analysed all proposed amendments and assessed the benefits and costs of implementing them in the EU. EFRAG reached the following general conclusions: As far as the terminology and editorial changes in part II is concerned, EFRAG concluded that, "apart from the year one costs that will arise for preparers in reading and understanding the amendments made, there will no be any measurable implementation costs involved". EFRAG also shared the IASB view that these amendments were expected to have no or minimal effect on accounting⁴.

Regarding part I, i.e. amendments that result in accounting changes for presentation, recognition or measurement purposes, EFRAG concluded that the majority will not have any major impact on users and preparers. However, EFRAG deemed that the following issues were important to study in more detail:

- ***Amendment to IAS 16 Property, Plant and Equipment – Sale of assets held for rental:*** EFRAG concluded that this amendment will better reflect the economic substance of these transactions and could reduce the work for users. Regarding the costs involved, companies involved in these transactions will have to set up new tracking procedures, but in most cases companies will already have such systems in place. EFRAG considered that overall the amendment will not lead to significant year one costs.

³ Amendments to IFRS 5 become effective for annual periods beginning on or after 1 July 2009, with earlier application permitted. However, an entity shall not apply the amendments for annual periods beginning before 1 July 2009 unless it also applies IAS 27 (as amended in May 2008).

⁴ See also paragraph 7 of EFRAG's Endorsement Advice

- ***Amendment to IAS 20 Accounting for Government Grants and Disclosure of Government Assistance – Government loans with a below-market rate of interest:*** EFRAG concluded that this amendment will reduce uncertainty for preparers and will improve the understandability and comparability of the financial information provided to users. EFRAG also pointed out that preparers will not incur significant costs and for users the costs will be insignificant.
- ***Amendment to IAS 40 Investment Property – Property under construction or development for future use as investment property:*** EFRAG concluded that this amendment will reduce divergence in practice and will enhance consistency and comparability of the information provided. Regarding the costs, EFRAG considered that they are unlikely to be significant, but that it can result in some additional costs for some preparers. The amendment will not impose additional burden on users.
- ***Amendment to IAS 41 Agriculture – Additional biological transformation:*** EFRAG concluded that this amendment will reduce divergence in practice and will enhance consistency and comparability of the information provided. Some entities will have to change their valuation methodology, but EFRAG pointed out that the additional costs are unlikely to be significant. The amendment will not impose additional burden on users.

The Commission Services agree with EFRAG's assessment on the importance of the different proposals and on the need to analyse some of them more in detail.

Will the amendments increase the quality of the accounting information provided in the financial statements?

EFRAG's analysis concluded that the amendments to the standards are likely either to improve the financial information provided or have no effect on the information⁵. In their tentative conclusion, EFRAG noted that the improvements of most of the amendments taken individually are likely to be relatively small, but that a handful of the amendments will have a noticeable effect on the quality of the information provided. EFRAG furthermore noted that the amendments will result in enhanced consistency and comparability between entities. This conclusion was shared by the EFRAG User Panel.

The Commission Services agree with the EFRAG analysis and conclude that the *Improvements to IFRSs* will overall improve the quality of the financial information and therefore benefit users.

Assessment of implementation costs

EFRAG's analysis gives an overview of the expected incremental costs for preparers and users. The analysis concludes that the *Improvements to IFRSs* will result in some additional initial and ongoing costs for some preparers. EFRAG concluded that taken individually the

⁵ See also paragraph 28 of EFRAG's Endorsement Advice

costs involved for some of the amendments will generally be insignificant and, when considered in aggregate, those costs will still not be significant.

EFRAG concluded that the amendments will involve no incremental costs for users.

EFRAG notes that the amendments are likely to involve some additional year one and ongoing costs to preparers, but considers that these costs in aggregate will not be significant. The amendments will involve no incremental cost for users. The Commission Services share this analysis.

4. OVERALL COST-BENEFIT CONSIDERATIONS AND COMMISSION SERVICES CONCLUSIONS

On the basis of EFRAG's Effect Study, the Commission Services have considered the main costs and benefits of endorsing *Improvements to IFRSs* and conclude that the benefits of the revision is likely to outweigh the costs introduced by the revision.

The Commission Services believe that *Improvements to IFRSs* will have positive cost-benefits effects and that it should therefore be endorsed in the EU without delay.

Attachment 1



European Financial Reporting Advisory Group ■

The costs and benefits of implementing the Improvements to International Financial Reporting Standards in the EU

Introduction

- 1 Following discussions between the various parties involved in the EU endorsement process, it has been decided that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of the Improvements to International Financial Reporting Standards. This report sets out that information.
- 2 EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly 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 Improvements to IFRSs, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work. (The results of the consultations EFRAG has carried out seem to confirm this.) Therefore, as explained more fully in the main sections of the report, the approach EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the Improvements to IFRSs in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

EFRAG's endorsement advice

- 3 EFRAG already carries out a *technical* assessment of all new and revised Standards and Interpretations issued by the IASB and IFRIC against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

Description of the Improvements to IFRSs

- 4 The IASB has adopted an annual process to deal with non-urgent, but necessary, minor amendments to IFRSs (the 'annual improvements process'). Issues dealt with in this process arise from matters raised by the International Financial Reporting Interpretations Committee (IFRIC) and suggestions from staff or practitioners, and focus on areas of inconsistency in IFRSs or where clarification of wording is required.
- 5 The amendments considered in this Invitation to Comment are the amendments to International Financial Reporting Standards (IFRSs) and the related Bases for Conclusions and guidance made in the International Accounting Standards Board's 2007 annual improvements project. Part I of the document includes those amendments

that result in accounting changes for presentation, recognition or measurement purposes, with the IASB's rationales included in related Bases for Conclusions. Part II includes those amendments that are terminology or editorial changes only, which the IASB expects to have no or minimal effect on accounting. The only changes to the Bases for Conclusions for these changes will be footnotes identifying when the changes were made.

- 6 Set out in this report is a description of each of the individual amendments making up the 2007 Improvements to IFRSs.

Part I

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Plan to sell the controlling interest in a subsidiary

- 7 In accordance with paragraph 6 of IFRS 5 an entity should classify a non-current asset or a disposal group as held for sale when the carrying amount of the asset (or group of net assets) will be recovered principally through a sale transaction. Paragraphs 7-8 go on to explain that the sale should be highly probable in order to qualify as held for sale.
- 8 Sometimes an entity enters into a commitment to sell the controlling interest in a subsidiary, but retains a non-controlling interest in that former subsidiary (such as an investment in an associate, an investment in a joint venture or a financial asset). There is uncertainty as to how the requirements in IFRS 5 should be applied by the entity in such circumstances.
- 9 The uncertainty arises because IFRS 5 is not clear on how much of a non-current asset or a disposal group needs to be disposed of for the asset or group to be considered as recovered principally through a sale and therefore classified as held for sale. In practice it seems that the term "principally" in paragraph 5 of IFRS 5 is being interpreted in different ways, for instance:
 - (a) Some believe being committed to a plan involving loss of control over a subsidiary is the triggering event for the classification as held for sale.
 - (b) Others believe the majority of the interest in the subsidiary has to be disposed of to meet the criteria for classification as held for sale.
- 10 The Amendment is intended to clarify the above uncertainty. It clarifies that, when an entity enters into a commitment to sell a subsidiary, it should classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out in paragraphs 6-8 of IFRS 5 are met, regardless of whether the entity retains a non-controlling interest in its former subsidiary after the sale. It also clarifies what disclosure is required in such situations.

IAS 1 Presentation of Financial Statements

Current/non-current classification of derivatives

- 11 The IASB identified an inconsistency in IAS 1 *Presentation of Financial Statements* regarding the current/non-current classification of derivatives. The IASB has been concerned that the guidance in paragraphs 68 and 71 of IAS 1 might be read to imply that all financial assets and financial liabilities classified as held for trading in

accordance with IAS 39 are required to be presented as current. The IASB reasons that this would be in contradiction to the criteria for the differentiation of current assets and liabilities from non-current assets and liabilities set out in paragraphs 66 and 69 in IAS 1.

- 12 The IASB is therefore amending the examples in paragraphs 68 and 71 of IAS 1 to remove the potential implication that financial assets and financial liabilities that are classified as held for trading in accordance with IAS 39 are required to be presented as current.

IAS 16 Property, Plant and Equipment

Recoverable amount

- 13 In IAS 16 Property, Plant and Equipment, “recoverable amount” was defined as the higher of an asset’s net selling price and its value in use. However:
 - (a) IAS 36 Impairment of assets defines the same term differently. Its definition is “the higher of its fair value less costs to sell and its value in use”.
 - (b) The IASB has also noted that paragraph 15 of IFRS 5 Non-current Assets Held for Sale and Discontinued Operations requires entities to measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.
- 14 There was perceived to be some inconsistency between these definitions and requirements. The IASB has therefore amended IAS 16’s definition to bring it into line with IAS 36 and IFRS 5.

Sale of assets held for rental

- 15 In various industries – such as car rental, aircraft manufacturing, heavy equipment, shipping, and property industry – some entities manufacture or acquire assets with the intention of first renting them out to third parties under an operating lease, then selling them. Previously, there was a diversity of practice as to how the sales of such dual intention assets were presented in the financial statements.
- 16 The IASB has therefore amended IAS 16 *Property, Plant and Equipment* for entities whose ordinary activities include renting and subsequently selling the same assets, requiring revenue to be recognised both when the asset is rented and when it is sold. The IASB also made a consequential amendment to IAS 7 *Statement of Cash Flows* in respect of this issue to require presentation of the corresponding cash flows within operating activities. Finally, the IASB clarified in the amendment that IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* should not be applied in these circumstances.

IAS 19 Employee Benefits

Curtailments and negative past service cost

- 17 The IASB is amending IAS 19 in respect of plan amendments because it believes the definitions of negative past service costs and curtailments are ambiguous and are resulting in diverse accounting for plan amendments that reduce existing benefits. The amendment clarifies that, when a plan amendment reduces benefits for future service, the reduction relating to future service is a curtailment and any reduction relating to

past service is a negative past service cost. The IASB is also deleting a reference to materiality in paragraph 111 of IAS 19.

Plan administration costs

- 18 The IASB believes it has identified an inconsistency in IAS 19 between the definition of 'return on plan assets' and the way in which that term is used. It is eliminating this inconsistency by amending the definition of 'return on plan assets' to require the deduction of plan administration costs only to the extent that such costs have not been reflected in the measurement of the defined benefit obligation.

Replacement of term 'fall due'

- 19 The IASB is replacing the term "fall due wholly" in the definitions of "short-term employee benefits" and "other long-term employee benefits" with "are due to be settled", in order to address a perceived inconsistency between the definition of short-term employee benefits in IAS 19.7 "benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render related service" and the examples thereof in IAS 19.8(b) "short-term compensated absence (such as paid annual leave and paid sick leave) where the absences are expected to occur within twelve months after the end of the period in which the employee render the related employee service".
- 20 The IASB concluded that the critical factor in distinguishing between long-term and short-term benefits is the timing of the expected settlement. Therefore, the IASB clarified that long term benefits are those that are not due to be settled within 12 months after the end of the period in which the employees rendered the service.
- 21 This distinction between short-term and long-term benefits is consistent with the current/non-current liability distinction in IAS 1 *Presentation of Financial Statements*. However, the fact that for presentation purposes a long-term benefit may be split into current and non-current portions does not change how the entire long-term benefit would be measured.

Guidance on contingent liabilities

- 22 Paragraph 32B of IAS 19 *Employee Benefits* states that contingent liabilities are required to be recognised under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This is inconsistent with IAS 37, which actually states that contingent liabilities should not be recognised. The IASB is therefore removing the reference to recognition from IAS 19.

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

Government loans with a below-market rate of interest

- 23 The IASB amended IAS 20 *Government Grants* to remove an inconsistency with IAS 39 *Financial Instruments: Recognition and Measurement* related to accounting for loans with a below-market rate of interest received from the government. IAS 39 requires all loans to be recognised at fair value on initial recognition. It follows from this requirement that if a loan bears a below-market interest rate its fair value need to be estimated and the loan is initially recognised at that amount. The fair value of the loan can be estimated using the discounted cash flow model in accordance with which all future cash flows are discounted using the market rate for a similar instrument with a similar credit rating.

- 24 Any difference between the fair value of the loan and the total loan proceeds is required to be accounted for separately in accordance with applicable IFRS requirements. In case of below-market interest government loans that difference would be the benefit of the reduced interest that entities receive from the government which need to be reported separately as a government grant. However, prior to the amendment IAS 20 stated that the benefit of the reduced interest should not be quantified and reported separately.
- 25 The amendment removes this inconsistency by requiring government loans to be recognised and measured in accordance with IAS 39 and the benefit of the reduced interest to be accounted for separately applying provisions of IAS 20. The benefit of the government loan will be measured at the inception of the loan as the difference between the cash received under the loan agreement and the fair value of the loan at which it is initially recognised.

IAS 23 Borrowing Costs

Components of borrowing costs

- 26 The IASB is concerned that, although the components of borrowing costs listed in paragraph 6(a)-(c) of IAS 23 are broadly equivalent to the components of interest expense calculated using the effective interest method in accordance with IAS 39, they are not identical. The IASB is therefore replacing paragraphs 6(a) to (c) of IAS 23 with a cross reference to interest expense calculated in accordance with the 'effective interest method' as defined in IAS 39 in order to insure consistency.

IAS 27 Consolidated and Separate Financial Statements

Measurement of subsidiary held for sale in separate financial statements

- 27 This issue relates to an inconsistency between IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 27 *Consolidated and Separate Financial Statements* on the measurement of a subsidiary classified as held for sale when a parent applies a policy of accounting for subsidiaries in accordance with IAS 39 in its separate financial statements. A similar issue also exists when a parent entity accounts for associates and joint ventures under IFRS in its separate financial statements.
- 28 Paragraph 38 of IAS 27 requires a parent to account for investments in subsidiaries, jointly-controlled entities and associates in its separate financial statements either at cost or in accordance with IAS 39, unless such investments are classified as held for sale, in which case IAS 27 requires them to be accounted for under IFRS 5. However, IFRS 5 excludes from the scope of its measurement requirements financial assets accounted for in accordance with IAS 39.
- 29 The IASB is resolving this issue by limiting the reference in IAS 27.38 to IFRS 5 to investments being accounted for at cost; henceforth, the measurement of investments accounted for in accordance with IAS 39 is not changed even if these investments are being held for sale. The underlying issue here is whether such investments should be measured at fair value less costs to sell (IFRS 5) or fair value (IAS 39).

IAS 28 Investments in Associates

Required disclosures when investments in associates are accounted for at fair value through profit or loss

- 30 The IASB has identified an apparent inconsistency in the disclosure requirements for entities that are eligible to and elect to account for investments in associates at fair value in accordance with IAS 39. These entities are excluded from the scope of IAS 28 and, therefore, are not required to give the disclosures that this standard would otherwise require. However, IAS 32 and IFRS 7 both require entities that account for investments in associates in accordance with IAS 39 to give the disclosures required by IAS 28 in addition to the disclosures required by IAS 32 and IFRS 7.
- 31 The IASB is addressing this inconsistency by removing from IAS 32 and IFRS 7 the general requirement to give the IAS 28 disclosures, and instead specifying in IAS 28 the specific disclosures that should be given. In particular, the amendment is that entities would provide the disclosures required by IAS 28.37(f) (re significant restrictions on the ability of associates to transfer funds to the investor).

Impairment of investment in associate

- 32 Under IAS 28 Investments in Associates associates within the scope of IAS 28 are accounted for using the equity method; in other words, the investment is initially recognised at cost and the carrying amount is subsequently increased or decreased to recognise the investor's share of the profit or loss of the associate. Goodwill arising upon the acquisition is thus included within the carrying amount of the investment and is not amortised within the books of the investor, nor is amortisation of the goodwill taken into account in determining the investor's share of the profit or loss of the associate.
- 33 One implication of this accounting is that, because the goodwill is not separately recognised, it is not tested for impairment separately as would be required by IAS 36 *Impairment of Assets*, but rather treated as part of the carrying amount of the investment as a whole. The question arises as to whether the same principle applies when an impairment loss or a reversal of a previously recognised loss occurs, i.e. no allocation of the impairment loss is made between the part of the impairment loss that relates to the goodwill element of the investment and the rest of the investment. The IASB is clarifying that no such allocation is made and that consequently any subsequent reversal of impairment losses should also be recognised in full.

IAS 31 Interests in Joint Ventures

Required disclosures when interests in jointly controlled entities are accounted for at fair value through profit or loss

- 34 The IASB has identified an apparent inconsistency in the disclosure requirements for entities that are eligible to and elect to account for investments in jointly controlled entities at fair value in accordance with IAS 39. These entities are excluded from the scope of IAS 31, and, therefore, are not required to give the disclosures that those standards would otherwise require. However, IAS 32 and IFRS 7 both require entities that account for investments in jointly controlled entities in accordance with IAS 39 to give the disclosures required by IAS 31 in addition to the disclosures required by IAS 32 and IFRS 7.

- 35 The IASB is addressing this inconsistency by removing from IAS 32 and IFRS 7 the general requirement to give the IAS 31 disclosures, and instead specifying in IAS 31 the specific disclosures that should be given. Those disclosures are:
- (a) the IAS 31.55 disclosures about the aggregate amount of the venturer's commitments relating to its own, and its jointly incurred share of, capital commitments in respect of the joint ventures; and
 - (b) the IAS 31.56 disclosures about a listing and description of interests in significant joint ventures and its proportion of ownership of jointly controlled entities.

IAS 36 Impairment of Assets

Disclosure of estimates used to determine recoverable amount

- 36 IAS 36 *Impairment of Assets* defines the recoverable amount of an asset or cash generating unit (CGU) as "the higher of the asset's or CGU's fair value less costs to sell and its value in use". When the recoverable amount is to be used in the absence of a binding sales contract or an active market, fair value less costs to sell would, like value in use, be derived from estimates of future cash flows. Yet the disclosures required by IAS 36 in this case were very different from those required when value in use is used,
- 37 The IASB addressed this inconsistency by amending IAS 36 to require the same disclosures to be given when an asset is measured at fair value less costs to sell, with that amount being estimated using discounted cash flows, as are already required when an asset is measured at value in use.

IAS 38 Intangible Assets

Advertising and promotional activities

- 38 IAS 38 requires expenditure on advertising or promotional activities, training activities and start-up activities, and on relocating or reorganising part or all of an entity to be recognised as an expense as incurred. Divergent interpretations have developed about when such expenses are incurred. This proposed amendment clarifies the meaning of 'as incurred' in this context. It also makes clear that an entity may recognise the prepayment of such expenditure as an asset only until the reporting entity has access to the goods or has received the services.

Units of production method of amortization

- 39 When finalising IFRIC 12 *Service Concession Arrangements*, the IASB noted that the wording used in IAS 38.98 when discussing when to use depreciation methods that involve low levels of depreciation initially ("there is rarely, if ever" persuasive evidence to support such an amortisation method) was being interpreted by many to mean "never". As a result, commentators were arguing that the use of the unit of production amortisation method could not be used under IFRIC 12's intangible asset model, even though it might reflect the expected pattern of consumption.
- 40 The IASB decided that this was not the intention of the words in IAS 38.98. It therefore clarified things by deleting the relevant sentence of paragraph 98.

IAS 39 Financial Instruments: Recognition and Measurement

Reclassification of derivatives into or out of the classification of at fair value through profit or loss

- 41 The IASB has identified an inconsistency within IAS 39: *Financial Instruments: Recognition and Measurement*. Paragraph 50 of IAS 39 prohibits the classification of financial instruments into or out of the fair value through profit or loss category after their initial recognition. However, IAS 39 subsequently appears to contradict this prohibition without including specific exceptions from paragraph 50. These cases are:
- (a) A possibility to move a derivative in and out of the profit or loss category any time while the derivative is outstanding if an entity designates a derivative as a hedging instrument or stops such a designation. This is because IAS 39 allows a derivative be designated as a hedging instrument any time while the derivative is outstanding; the entity might also have to stop hedge accounting if the hedge relationship is no longer effective or it might elect to stop hedge accounting any time.
 - (b) A requirement in IAS 39 to reclassify a portfolio of financial assets and financial liabilities into the fair value through profit or loss category for which evidence arises for the first time of a recent actual pattern of short-term profit taking; and
 - (c) A requirement in IAS 39 to reclassify a financial instrument into the fair value through profit or loss category if the instrument is transferred into a portfolio for which there is evidence of a recent actual pattern of short-term profit taking.
- 42 The IASB is amending definitions of a financial instrument classified as held for trading to make it clear that the classification into the held-for-trading category is made on initial recognition.
- 43 The IASB further clarifies in what circumstances specific financial instruments start or cease to be accounted for at fair value through profit or loss. In this respect, the IASB concluded that the circumstances when a derivative starts or stops being designated as a hedging instrument were not exceptions from the principle that there should be no reclassifications because they were changes in circumstances and not reclassifications.

Designating and documenting hedges at the segment level

- 44 The IASB believes there is a conflict between paragraph 73 of IAS 39 and the requirements of IFRS 8 *Operating Segments*. Paragraph 73 of IAS 39 refers to the need for hedging instruments to involve a party external to the reporting entity. In doing so, it uses a segment as an example of such a party. IFRS 8 requires the identification of the segments and the information provided in respect of each of those identified segments to be based on the information that is reported to the chief operating decision maker – meaning that there is no requirement that the hedge accounting used in the segment information shall be IFRS-compliant. Therefore, the two IFRSs appear to be in conflict and the IASB is amending IAS 39 to remove references to the designation of hedging instruments at the segment level.

Applicable effective interest rate on cessation of fair value hedge accounting

- 45 The IASB has identified an apparent inconsistency in the application guidance in IAS 39 (AG8), relating to whether the revised or the original effective interest rate of a debt

instrument should be applied in the remeasurement of the instrument's carrying amount on the cessation of fair value hedge accounting. A revised effective interest rate is calculated when fair value hedge accounting ceases. The IASB is therefore amending IAS 39 to clarify that the revised effective interest rate calculated for a hedged item in the fair value hedge accounting in accordance with paragraph 92 should be used for the remeasurement of the hedged item when paragraph AG 8 is applicable.

IAS 40 Investment Property

Property under construction or development for future use as investment property

- 46 When IAS 40 *Investment Property* was being developed, the IASB was concerned about difficulties in estimating reliably the fair value of investment property under construction. It decided as a result that revaluations of investment property under construction should not be permitted, and it excluded such property from the scope of IAS 40 and instead included it within the scope of IAS 16 because it believed that that would have the effect of prohibiting such revaluations (see IAS 40 BC 17-18).
- 47 The IASB has noted that investment property being redeveloped remained in the scope of this Standard and that the exclusion of investment property under construction gave rise to a perceived inconsistency. In addition, the IASB concluded that, with increasing experience with the use of fair value measures since this Standard was issued, entities were more able to measure reliably the fair value of investment property under construction.
- 48 Therefore, the IASB has decided to amend IFRS to permit revaluations of investment property under construction. It is therefore amending IAS 40 to include investment property under construction within its scope and also to allow investment property under construction to be measured at cost if fair value cannot be measured reliably until such time as the fair value becomes reliably measurable or construction was completed (whichever comes earlier).

IAS 41 Agriculture

Discount rate for fair value calculations

- 49 The IASB has noted that the existing wording of paragraph 20 of IAS 41 *Agriculture* requires the use of a pre-tax discount rate to estimate the fair value of a biological asset. In its view that wording unnecessarily restricts the valuation methodology that may be applied. The IASB is therefore amending IAS 41 to remove the restriction. The amendment requires a current market-determined rate to be used but permits this to be a pre-tax or post-tax rate according to the valuation methodology used to determine fair value.

Additional biological transformation

- 50 IAS 41 currently does not permit 'additional biological transformation' (ie "the processes of growth, degeneration, production and procreation that cause qualitative or quantitative changes in a biological asset") to be taken into consideration when calculating fair value using discounted cash flows. The reason such transformations are excluded, paragraph 21 of IAS 41 explains, is because the objective is to determine the fair value of a biological asset in its present location and condition, and that present

condition excludes any increases in value from additional biological transformation and future activities of the entity.

- 51 However, the IASB is amending IAS 41 to remove the prohibition on taking 'additional biological transformation' into consideration when calculating fair value using discounted cash flows. There are several reasons for making this amendment:
- (a) Apparently there is diversity in practice resulting from different interpretations of the existing prohibition requirement, and the IASB wishes to eliminate this diversity.
 - (b) Having reconsidered the matter, the IASB has concluded that not including these cash flows results in a carrying amount that is not representative of the asset's fair value.
 - (c) The IASB also observes that the risks associated with cash flows from 'additional biological transformation' would be considered in determining the discount rate.

Part II

IFRS 7 Financial Instruments: Disclosures

Presentation of finance costs

- 52 The IASB is amending the implementation guidance in IFRS 7 *Financial Instruments: Disclosures* because there is a potential conflict between that guidance and IAS 1 *Presentation of Financial Statements* (as revised in 2007). IAS 1 prohibits the presentation of *net* finance costs (or a similar term) in the statement of comprehensive income unless the finance costs and finance revenue included in the net total are disclosed. Paragraph IG13 of IFRS 7 indicates that total interest income and total interest expense could be included as a component of finance costs. The IASB is resolving the potential conflict by amending paragraph IG13.

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

Status of implementation guidance

- 53 The IASB has been told that paragraph 7 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* could be misinterpreted as requiring the mandatory application of Implementation Guidance. It is therefore amending a few paragraphs of IAS 8 to clarify the status of implementation guidance.

IAS 10 Events after the Reporting Period

Dividends declared after the end of the reporting period

- 54 The IASB identified a potentially unclear explanation in the guidance in IAS 10 *Events after the Reporting Period*. The explanation relates to why a dividend declared after the balance sheet date does not result in the recognition of a liability. That explanation (given in paragraph 13 of the standard) is that dividends declared after the balance sheet date but before finalisation of the financial statements are not recognised as a liability at the balance sheet date because ("they do not meet the criteria of a present obligation in IAS 37").

- 55 The IASB's concern is that some may read the above explanation as implying that a liability should be recognised for dividends not declared until after the balance sheet date if there is an established pattern of paying a dividend. The IASB believes it would not be appropriate to recognise a liability in such circumstances, and is therefore amending IAS 10 so that it cannot be read in that way.

IAS 18 Revenue

Costs of originating a loan

- 56 The IASB has identified an inconsistency between the guidance in the Appendix accompanying IAS 18 *Revenue* and IAS 39 *Financial Instruments: Recognition and Measurement*. Paragraph 14 (a) (i) of the Appendix to IAS 18 discusses origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under IAS 39 is classified as a 'financial asset at fair value through profit or loss'. It states that "...these fees are an integral part of generating an involvement with the resulting financial instrument and, together with *the related direct costs* are deferred and recognised as an adjustment to the effective interest rate." (Emphasis added). The IASB has concerns about the words "related direct costs": IAS 18 does not seem to require such costs to be incremental while IAS 39 uses the term "transaction costs" and defines them as related incremental direct costs.
- 57 The IASB thinks the result is that standards are inconsistent as to the identification of costs incurred in originating a financial asset that should be deferred and recognised as an adjustment to the effective interest rate. It is therefore eliminating this inconsistency.
- 58 The IASB believes that the definition of transaction costs in IAS 39 is more appropriate and should be used to determine the costs that are deferred in accordance with IAS 18 on the origination of a loan. As a result, it is amending IAS 18 by replacing the phrase "related direct costs" in the above sentence with "related transaction costs (as defined in IAS 39)".

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

Consistency of terminology with other IFRSs

- 59 The IASB has identified that IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* uses some terms that are inconsistent with defined terms or with more widely used terms for equivalent items in other standards. The IASB concluded that the consistency of IFRS would be improved if the terms used by IAS 20 were changed to the equivalent defined or more widely used terms. The inconsistencies are that IAS 20 uses:
- (a) 'taxable income' instead of 'taxable profit or tax loss';
 - (b) 'as income' instead of 'in profit or loss'; and
 - (c) 'revision to an accounting estimate' instead of 'change in accounting estimate'.
- 60 The IASB also noted that these inconsistencies are repeated in the discussion about government grants in IAS 41 *Agriculture*.
- 61 The IASB has therefore amended IAS 20 and IAS 41 to eliminate these inconsistencies, and at the same time has made a few other wording improvements to the standards.

IAS 29 Financial Reporting in Hyperinflationary Economies

Consistency of terminology with other IFRSs

- 62 The IASB has identified that paragraph 6 of IAS 29 *Financial Reporting in Hyperinflationary Economies* contains an out-of-date description of the measurement basis used in financial statements. For example, it says assets and liabilities are at cost except “to the extent that property, plant and equipment and investments may be revalued”. In other words, it does not reflect that there are now several other balance sheet categories that may or must be measured on the basis of a current value (such as fair value) rather than a historical value. The IASB also believes the standard uses some out-of-date or inconsistent terminology. In particular, it:
- (a) uses the term ‘market value’ in IAS 29 to describe existing measurement practice instead of the defined term ‘fair value’;
 - (b) uses the terms ‘results of operations’ and ‘net income’ when other standards use the term ‘profit or loss’ and
 - (c) refers to ‘investments’ as non-monetary assets carried at cost. Most investments are now measured at fair value in accordance with IAS 39.
- 63 The IASB has therefore updated IAS 29’s descriptions of current practice and brought its terminology into line with other standards.

IAS 34 Interim Financial Reporting

Earnings per share disclosures in interim financial reports

- 64 Paragraph 11 of IAS 34 *Interim Financial Reporting* requires the disclosure of basic and diluted earnings per share in an interim report. However, it did not make it clear that this disclosure is required only if the entity falls within the scope of IAS 33 *Earnings Per Share*.
- 65 The IASB amended IAS 34 to require the presentation of basic and diluted earnings per share only when the entity is within the scope of IAS 33.

IAS 40 Investment Property

Consistency of terminology with IAS 8

- 66 When IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* was revised as part of the last improvements project, a consequential amendment should have been made to align paragraph 31 of IAS 40 *Investment Property* with IAS 8. The IASB therefore amended paragraph 31 of IAS 40 to ensure consistency with the text of IAS 8.

Investment property held under lease

- 67 The IASB has noted that there was ambiguous wording in IAS 40 *Investment Property* regarding the fair value of investment property held under a lease. In particular, paragraph 50(d) seemed to imply that by simply adding back any recognised lease liabilities one arrives at the fair value of an investment property held under a lease.

- 68 The IASB realised that this suggests that the fair value of an investment property asset held under a lease is equal to the net fair value plus the carrying amount of any recognised lease liability; and that was not correct. The IASB therefore amended IAS 40 to make clear how an investment property under lease should be recorded.

IAS 41 Agriculture

Examples of agricultural produce and products

- 69 The IASB is revising the examples of agricultural produce and products that are the result of processing after harvest. Under IAS 41 it is very important to be able to differentiate a biological asset and agricultural produce from products that are the result of processing that agricultural produce. For that reason, in paragraph 4 of IAS 41 there is a table that provides examples of biological assets, the agricultural produce that results from harvesting those biological assets, and products that are the result of processing that harvested produce.
- 70 The IASB believes that one of the examples in that table is incorrect: logs are described as the agricultural produce of trees, when in fact felled trees are the agricultural produce and logs (and other forms of lumber) are the products that result from processing that agricultural produce. The IASB is therefore amending the table.

Point-of-sale costs

- 71 IAS 41 *Agriculture* used the term “point-of-sale costs”. This term was not used elsewhere in IFRSs. Instead the term “costs to sell” is used in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 36 *Impairment of Assets*.
- 72 The IASB concluded that “point-of-sale costs” and “costs to sell” meant the same thing in the context of IAS 41. Therefore, it decided to replace the terms “point-of-sale costs” and “estimated point-of-sale costs” with “costs to sell” to make IAS 41 consistent with IFRS 5 and IAS 36.

EFRAG’s initial analysis of the costs and benefits of the Improvements to IFRSs and Stakeholders’ views on it

- 73 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing the Improvements to IFRSs, both in year one and in subsequent years.
- 74 On the basis of that initial assessment, EFRAG tentatively concluded (as explained in the basis for conclusion to the endorsement advice letter) that the Amendments are likely to result in improvements in the quality of the information provided. Taken individually, most of these improvements are likely to be relatively small. However, EFRAG believes that a handful of the amendments will have a noticeable effect on the quality of the information provided.
- 75 EFRAG further tentatively concluded that the Improvements to IFRSs are:
- (a) likely to involve some preparers in some additional year one and ongoing costs. Although for a few companies the costs could be more significant, some entities will already be applying some IFRSs in a way that is identical or very similar to that required by the amendments and for those entities it is likely that there will be little if any incremental cost involved in implementing those particular amendments. As a result, EFRAG’s assessment is that taken individually the

costs will generally be insignificant and, when considered in aggregate, those costs will still not be significant.

(b) likely to involve users in no year one or ongoing incremental costs.

76 Finally, EFRAG also tentatively concluded that the benefits it expected to arise from applying the Improvements to IFRSs were likely to exceed the costs involved in its implementation.

77 EFRAG published the above results of its initial assessment on 22 May 2008, together with a detailed supporting analysis. It invited comment on the material by 23 June 2008. EFRAG received 8 letters in response. The results of this consultation can be summarised as follows. Where specific responses to the questions posted were provided by respondents:

(a) All respondents agreed with EFRAG's assessment of the costs involved for users and preparers

(b) All respondents agreed with most of EFRAG's assessments of the benefits associated with implementing the amendments. Three respondents (all of them preparer from the retail sector) raised particular concerns about the amendment to IAS 38 – Advertising and promotional activities. They argued that the amendment will not lead to financial statements fairly presenting their financial position and financial performance. In their view, financial statements will be less comparable to those prepared in accordance with US GAAP and those of other retailers.

78 In addition, EFRAG consulted its User Panel in June 2008 on the impact that the Improvements to IFRSs would have on users. User Panel members confirmed EFRAG's assessment of the costs to users that will arise from implementing the Amendments.

EFRAG's final analysis of the costs and benefits of the Improvements to IFRSs

79 Based on its initial analysis and the stakeholders' views on that analysis, EFRAG's detailed final analysis, position and arguments are presented in the paragraphs below.

80 EFRAG started its assessment of the costs and benefits of implementing the Improvements to IFRSs in the EU by considering whether they were likely to be any measurable costs involved for preparers or users in implementing any of the amendments in Part II of the standard. (These amendments are the ones that the IASB believes will have "no or minimal effect on accounting".) EFRAG's final assessment is that, apart from the year one costs that will arise for preparers in reading and understanding the amendments made, there will not be any measurable implementation costs involved.

81 EFRAG then considered the 23 amendments included in Part I. Again, there will be a year one cost for preparers in reading and understanding the amendments made. Furthermore, some of the amendments involve additional disclosures and additional disclosures always involve some cost for preparers. (The costs of reading and understanding the amendments and in providing the additional disclosures are discussed further in the next paragraphs.) That apart, EFRAG's final assessment is that 19 of the amendments in Part I are unlikely to involve any measurable implementation costs for preparers and users. Those 19 amendments are:

- IFRS 5 – Plan to sell the controlling interest in a subsidiary
- IAS 1 – Current/non-current classification of derivatives
- IAS 16 – Recoverable amount
- IAS 19 – Curtailments and negative past service cost
- IAS 19 – Plan administration costs
- IAS 19 – Replacement of term ‘fall due’
- IAS 19 – Guidance on contingent liabilities
- IAS 23 – Components of borrowing costs
- IAS 27 – Measurement of subsidiary held for sale in separate financial statements
- IAS 28 – Required disclosures when investments in associates are accounted for at fair value through profit or loss
- IAS 28 – Impairment of investment in associate
- IAS 31 – Required disclosures when investments in jointly controlled entities are accounted for at fair value through profit or loss
- IAS 36 – Disclosure of estimates used to measure recoverable amount
- IAS 38 – Advertising and promotional activities
- IAS 38 – Units of production method of amortization
- IAS 39 – Reclassification of derivatives into or out of the classification of at fair value through profit or loss
- IAS 39 – Designating and documenting hedges at the segment level
- IAS 39 – Applicable effective interest rate on cessation of fair value hedge accounting
- IAS 41 – Discount rate for fair value calculations

The costs and benefits expected to arise from the remaining four amendments are discussed below.

Reading and understanding the amendments

- 82 Every change that is made to IFRS needs to be read and understood by preparers so that they can determine whether the change has any effect on them and, if it does, what that effect is. Normally the cost involved in doing this is insignificant compared to the other costs involved and to the benefits. EFRAG has considered whether that is also the case for the Amendments.
- 83 The Amendments comprise 34 separate amendments (some of which themselves involve several amendments) that affect 21 different standards. EFRAG’s final

assessment is that, although reading and understanding these amendments will not be a simple task, the year one costs involved will not be significant.

- 84 Some EFRAG members were concerned that some of the amendments added so little to existing IFRS that the cost of reading and understanding them might exceed the benefits to be derived from their implementation. However, EFRAG's assessment is based on a comparison of the overall costs and the overall benefits arising from the Amendments, rather than an assessment of each amendment's costs and benefits.

Additional disclosures

- 85 Some of the amendments require preparers to provide additional disclosures. These additional disclosures will result in additional ongoing publication costs, although that cost ought to be insignificant. Furthermore, in some cases the additional disclosures will also involve some additional year one and ongoing costs for preparers as they have to gather the required information as part of their financial statement preparation process. However, EFRAG's understanding is that generally all of the information needed to provide the additional disclosures will already be readily available within the entity. As a result, EFRAG's assessment is that again these costs ought to be insignificant.
- 86 EFRAG has also considered whether these additional disclosures will in some way increase the burden on users of financial statements. Its view is that the additional disclosures will impose no additional burden on users; rather, they will allow users to have an improved understanding of the financial statements.

Amendment A: IAS 16 – Sale of assets held for rental

Costs for preparers

- 87 The amendment requires preparers to transfer a dual intention asset after its rental period from property, plant and equipment into inventory and to account for any gain made on disposal as 'revenue', instead of 'other income'. The amendment also requires all related cash flows to be classified in the operating category of the cash flow statement. EFRAG noted that this represents simply a change in presentation and will therefore not in itself result in any additional year-one or ongoing costs.
- 88 However, preparers will be required to track all dual intention assets individually and transfer them individually from property, plant and equipment to inventory as each asset's rental period ends. This will involve setting up new tracking procedures and will therefore result in some incremental implementation and ongoing costs. In some cases the disposal of the asset will take place immediately after the end of the renting period, while in other cases the sale will take some time to occur. This means that different tracking accuracies might be possible.
- 89 In addition, entities will have to separate the cash flows of dual intention assets from other assets of property, plant and equipment, as the former cash flows will be included in the operating section of the cash flow statement, while the latter cash flows will be included in the investing section. This will result in additional implementation and ongoing costs in the preparation of the cash flow statement.
- 90 EFRAG believes that entities with a business model that involves selling previously rented assets as part of its normal part of operations will most likely have appropriate tracking systems in place. The costs of implementing the amendment will therefore be

limited to transferring information already available into the accounting system. Therefore, EFRAG's assessment is that for such entities the amendment will result in little incremental costs in year one and on an ongoing basis. EFRAG appreciates that other entities will not have the necessary systems in place and that this might result in higher incremental costs in year one as those systems are set up. Although this could be quite an extensive exercise for some entities, EFRAG believes that, across all preparers affected by the amendment, the year one costs will not be significant.

- 91 Entities are required to apply the amendment retrospectively, which will consist of reclassifications in balance sheet, income statement and cash flow statement. As the information needed to do this will normally be readily available, EFRAG's assessment is that this will not result in significant costs.

Costs for users

- 92 EFRAG has also considered whether the amendment will in some way increase the burden on users of financial statements. Its view is that it will impose no additional burden on users, but rather could decrease their work because it will no longer be necessary to adjust revenue (and other income) or the cash flow statement when the amounts involved are significant.

Benefits for preparers and users

- 93 EFRAG has concluded, for the reasons explained in the Basis for Conclusions attached to its endorsement advice that the amendment will better reflect the economic substance of the transaction. Further, as explained above, it could reduce the work of users. EFRAG therefore concluded that this should be beneficial to all stakeholders.

Amendment B: IAS 20 – Government loans with a below-market rate of interest

Costs for preparers

- 94 The amendment requires the benefit of a loan received from a government with a below-market rate of interest to be quantified by the imputation of market rate of interest in accordance with IAS 39.
- 95 Preparers would need to take the following steps in order to meet these requirements:
- (a) determine an appropriate market rate of interest to be used in the calculation of the fair value of the loan;
 - (b) estimate the present value of cash flows under the loan agreement using the discounted cash flow model; and
 - (c) separate the benefit of the reduced interest.
- 96 Going forward entities would have to account for the loan at amortised cost using the effective interest rate method and account for the reduced interest benefit as a government grant in accordance with IAS 20.
- 97 It is EFRAG's understanding that generally an amendment may prove more costly to implement if implementation requires significant system changes. It is possible that the above mentioned steps might indeed require some system changes. However, we do not envisage preparers incurring significant costs in this case because generally the techniques mentioned above, such as the use of the discounted cash flow model, are

not very complex and are widely applied by entities in their day to day operations anyway. In EFRAG's view that will be the case even though in some cases determining an appropriate market rate of interest to be used as an input in the discounted cash flow model may require expert advice from external consultants resulting in incremental consulting fees.

Costs for users

- 98 Users will incur some year one costs in understanding the new requirements. However in our view these costs will be insignificant.

Benefits for preparers and users

- 99 The amendments benefit preparers by eliminating the uncertainty as to how to apply existing IFRS to below-market interest rate government loans.
- 100 EFRAG has concluded, for the reasons explained in the Basis for Conclusions attached to its endorsement advice that the amendments improve the understandability and comparability of the financial information provided to users.

Amendment C: IAS 40 – Property under construction or development for future use as investment property

Costs for preparers

- 101 The amendment allows the selection of a consistent accounting model for investment property under construction and under redevelopment and further ensures an appropriate choice of accounting model, depending on the specific market circumstance.
- 102 Therefore, if an entity has selected the fair value accounting model for all its investment property, the effect of the amendment will be to require it to estimate some additional fair values (ie the fair value of investment property under construction), unless that fair value cannot be reliably measured.
- 103 Consequently, entities applying the fair value model will incur some incremental implementation costs for obtaining fair values for all existing property under construction. Entities will also incur additional ongoing costs, as recurring fair value updates have to be obtained for financial reporting purposes until completion of construction.
- 104 Entities not able to reliably estimate the fair value of investment property under construction will incur some costs in proving their inability to reliably estimate the fair value.
- 105 EFRAG concluded that the additional costs described above are unlikely to be significant—because entities will already have the appropriate procedures in place to obtain these values—unless property that is being constructed or developed for future use as investment property represents a substantial proportion of an entity's investment properties, in which case the additional valuations necessary (if the entity has chosen the fair value measurement model) could result in some significant additional costs.

Costs for users

- 106 EFRAG has also considered whether the amendment will in some way increase the burden on users of financial statements. Its view is that it will impose no additional burden on users.

Benefits for preparers and users

- 107 EFRAG has concluded, for the reasons explained in the Basis for Conclusions attached to its endorsement advice that the amendment will result in a reduction in divergence in practice, thereby enhancing consistency and comparability of the information provided. This should be a benefit to all stakeholders.
- 108 EFRAG also notes that, if property that is being constructed or developed for future use as investment property represents a substantial proportion of an entity's investment properties, those benefits are likely to be significant.

Amendment D: IAS 41 – Additional biological transformation

Costs for preparers

- 109 The effect of this amendment will be to require some entities to change the valuation methodology they use for biological assets to take into account biological transformation. Where market prices are readily available, this is unlikely to involve additional costs; indeed it might make the valuation process easier because those prices will already take biological transformation into account. However, where market prices are not readily available, valuation models will have to be revised and (perhaps) new inputs obtained, which is likely to involve some additional year one and ongoing incremental costs. EFRAG's assessment is however that these additional costs are unlikely to be significant.

Costs for users

- 110 EFRAG has also considered whether the amendment will in some way increase the burden on users of financial statements. Its view is that it will impose no additional burden on users.

Benefits for preparers and users

- 111 EFRAG has concluded, for the reasons explained in the Basis for Conclusions attached to its endorsement advice that the amendment will result in a reduction in divergence in practice, thereby enhancing consistency and comparability of the information provided. This should be a benefit to all stakeholders.

Transitional arrangements

- 112 Entities are required to apply some of the Amendments of Part I of the standard retrospectively. (The Proposed Improvements in Part II have no effective date.) Although in theory this could be quite an extensive exercise EFRAG believes that the accounting policies that will generally be used will mean that, across all preparers as a whole, the year one costs of doing this will not be significant.

Conclusion

- 113 To summarise, EFRAG's assessment is that the Improvements to IFRSs will involve no incremental costs for users.
- 114 The Amendments are likely to involve some preparers in some additional year one and ongoing costs. Although for a few companies those costs could be significant, some entities will already be applying some IFRSs in a way that is identical or very similar to that required by the amendments and for those entities it is likely that there will be little if any incremental cost involved in implementing those particular amendments. As a result, EFRAG's assessment is that taken individually those costs will generally be insignificant and, when considered in aggregate, the costs will still not be significant. On the other hand, the Amendments will result in enhanced consistency and comparability between entities. EFRAG's assessment is that this benefit is likely to outweigh the costs involved.

EFRAG
04 July 2008

Attachment 2



Jörgen Holmquist
Director General
European Commission
Directorate General for the Internal Market
1049 Brussels

04 July 2008

Dear Mr Holmquist

Adoption of the Improvements to International Financial Reporting Standards

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 we are pleased to provide our opinion on the adoption of the Improvements to International Financial Reporting Standards ('the Amendments'), which were published in May 2008. The Amendments were issued in an exposure draft which EFRAG commented on.

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

The amendments considered in this letter are the amendments to International Financial Reporting Standards (IFRSs) made in the International Accounting Standards Board's 2007 annual improvements project. Part I of the document includes those amendments that result in accounting changes for presentation, recognition or measurement purposes. Part II includes those amendments that are terminology or editorial changes only, which the IASB expects to have no or minimal effect on accounting.

An entity shall apply the amendments in Part I for annual periods beginning on or after 1 January 2009. Earlier application is permitted. The amendments in Part II have no effective date.

EFRAG has carried out an evaluation of the Amendments. As part of that process, EFRAG issued a draft evaluation for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and EFRAG's discussions of technical matters are open to the public.

EFRAG supports the Amendments and has concluded that they meet the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that:

- they are not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
- they 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.

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Amendments and, accordingly, EFRAG recommends their adoption. (EFRAG's reasoning is explained in the attached 'Appendix—Basis for Conclusions'.)

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

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix Basis for Conclusions

Set out below is the basis for the conclusions reached and for the recommendation made by EFRAG on the Improvements to International Financial Reporting Standards ('the Amendments').

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

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 European endorsement criteria, 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.

115 When evaluating the merits of the Amendments, EFRAG considered the following key questions:

- (a) Are the requirements of the Amendments consistent with the IASB's Framework for the Preparation and Presentation of Financial Statements ('the Framework')?
- (b) Would the Amendments' implementation result in an improvement in accounting?
- (c) Does the accounting that results from the application of the Amendments meet the criteria for EU endorsement?

116 Having formed tentative views on the issues and prepared a draft assessment report, EFRAG issued that draft for comment on 22 May 2008 and asked for comments on it by 23 June 2008. EFRAG has considered all the comments received in response, and the main comments received are dealt with in the discussion in this appendix.

Are the requirements of the Amendments consistent with the IASB's Framework?

117 EFRAG considered whether the requirements in the Amendments are consistent with the IASB's Framework. The Amendments focus primarily on providing clarification and additional guidance on some aspects of IFRSs, and do not introduce fundamental changes to existing IFRS literature.

118 When EFRAG considered whether existing IFRSs should be endorsed, it took into account whether their accounting treatments were consistent with the Framework. As the Amendments focus on providing clarification of and guidance on existing IFRSs, EFRAG concluded that no new issues arise relative to the Framework.

Would the Amendments' implementation result in an improvement in accounting?

119 EFRAG next asked itself whether the Amendments were likely to result in an improvement in the financial information provided, a deterioration, or make little difference.

- 120 The Amendments comprise 34 individual amendments. The IASB has divided those 34 amendments into two parts.
- (a) Part I includes those amendments that result in accounting changes for presentation, recognition or measurement purposes.
 - (b) Part II includes those amendments that are only terminology or editorial changes, which the IASB expects to have no or minimal effect on accounting.
- 121 EFRAG found this to be a useful classification for the purpose of its technical assessment because amendments that are expected “to have no or minimal effect on accounting” ought not to be a significant factor in the technical analysis. EFRAG therefore considered whether the amendments included in Part II were correctly classified. Having concluded that they were, EFRAG considered them no further in its technical analysis.
- 122 EFRAG then turned its attention to the 23 amendments included in Part I (in other words, the amendments that are expected to result in presentation, recognition or measurement changes). In EFRAG’s view, 19 of those amendments are both relatively straight forward, would result in improvements in accounting and would clearly meet the endorsement criteria. Those 19 amendments are:
- IFRS 5 – Plan to sell the controlling interest in a subsidiary
 - IAS 1 – Current/non-current classification of derivatives
 - IAS 16 – Recoverable amount
 - IAS 19 – Curtailments and negative past service cost
 - IAS 19 – Plan administration costs
 - IAS 19 – Replacement of term ‘fall due’
 - IAS 19 – Guidance on contingent liabilities
 - IAS 23 – Components of borrowing costs
 - IAS 27 – Measurement of subsidiary held for sale in separate financial statements
 - IAS 28 – Required disclosures when investments in associates are accounted for at fair value through profit or loss
 - IAS 28 – Impairment of investment in associate
 - IAS 31 – Required disclosures when investments in jointly controlled entities are accounted for at fair value through profit or loss
 - IAS 36 – Disclosure of estimates used to measure recoverable amount
 - IAS 38 – Units of production method of amortization
 - IAS 39 – Reclassification of derivatives into or out of the classification of at fair value through profit or loss

- IAS 39 – Designating and documenting hedges at the segment level
 - IAS 39 – Applicable effective interest rate on cessation of fair value hedge accounting
 - IAS 41 – Discount rate for fair value calculations
 - IAS 41 – Additional biological transformation
- 123 EFRAG decided however that the other four amendments are less straight forward and merit closer analysis. That analysis is set out in the paragraphs below.

Amendment A: IAS 16 – Sale of assets held for rental

- 124 The IASB identified some industries where entities are in the business of renting out and subsequently selling the same assets (so-called “dual intention assets”). Existing IAS 16 *Property, Plant and Equipment* prohibits the classification as revenue of gains arising from derecognition of items of property, plant and equipment, so income from renting out these assets is shown as revenue while income from selling them is not. The effect of the amendment is that entities whose ordinary activities include renting and subsequently selling the same assets will henceforth be required to recognise revenue from both renting and selling the assets. In the IASB’s view, the presentation of gross selling revenue, rather than a net gain or loss on the sale of the assets, better reflects the ordinary activities of such entities.
- 125 At the same time, the amendment clarifies that IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* should not be applied to such transactions.
- 126 EFRAG agrees that this amendment results in the financial statements better reflecting the substance of the ordinary activities of entities that are in the business of renting out and subsequently selling items of property, plant and equipment. Thus, the amendment improves the representational faithfulness, and therefore the reliability, of the information provided.
- 127 Some constituents are concerned that the amendment is fairly narrowly scoped and somewhat rules-based and that, as a result, it would not apply to activities that are similar in nature to those activities within the scope of the amendment (ie the renting out and subsequent sale of items of plant, property and equipment). Some were also concerned that there might not be a difference in substance between some of the assets within the scope of this amendment (and therefore scoped out of IFRS 5) and some assets within the scope of IFRS 5. However, EFRAG does not share these concerns. Furthermore, EFRAG is not persuaded by the argument concerning IFRS 5. In its view, IFRS 5 was not intended to address this type of circumstance; although the assets might have similar characteristics, the business purpose of dual intention assets is different and therefore it is appropriate to have a different accounting principle applied to such transactions.

Amendment B: IAS 20 – Government loans with a below-market rate of interest

- 128 IAS 20 and IAS 39 were not consistent in the treatment they required to be applied to below-market government loans and it was not clear which treatment should be applied in which circumstances. As a result, economically similar arrangements were being accounted for differently. In addition, the provisions in IAS 20 prior to the amendments implied that accounting for a loan depended on who the lender was: a commercial institution or the government. Loans received from commercial institutions are recorded

on initial recognition at their fair value in accordance with IAS 39 while loans received from the government may be not. The Amendments make it clear that IAS 39 should be applied and that the identity of the lender is an irrelevance.

- 129 Some EFRAG members note that entities that receive below-market interest rate government loans are often entities that experience financial difficulties and for which it might not be possible to receive a loan from any other lenders except for the government. In such cases there might be a degree of approximation involved in estimating the market interest rate that entities would have to use to calculate the present value of the cash flows under the loan agreement in order to record the loan in the financial statements at its fair value in accordance with IAS 39. As a result there is a concern that applying IAS 39 to such loans might result in less reliable information reported in primary financial statements. However, EFRAG notes that IFRS 7 *Financial Instruments: Disclosures* requires disclosure of the assumptions applied in determining fair values for a class of financial assets or financial liabilities if the fair value was determined based on a valuation model. Thus, entities will be required to provide information on the assumptions they used in applying the discounted cash flow model to determine the fair value of below-market interest rate loans on initial recognition. These disclosures would enable users to understand the degree of uncertainty in the reported amounts.
- 130 EFRAG further notes that the imputation of market interest rate would reveal the degree of support that the entity is receiving as a result of the government subsidised interest rate, and thus result in a faithful representation to be given of below-market interest rate government loans. This would enhance the reliability of the information provided. For that reason EFRAG has concluded that this amendment will not result in reliability concerns.
- 131 The amendments eliminate the uncertainty as to how to apply existing IFRS to below-market interest rate government loans, thus improving consistency and enhancing comparability. In addition, recognising that who provides a loan is not a relevant attribute to justify a difference in accounting for the loan—and therefore that below-market interest government loans should be within the scope of IAS 39 and accounted for in accordance with the provisions of that standard as any other loan—will improve understandability and comparability of the financial information provided to users.
- 132 Based on the above analysis, EFRAG has concluded that the amendment will result in an improvement in accounting.

Amendment C: IAS 38 – Advertising and promotional activities

- 133 IAS 38 requires expenditure on advertising or promotional activities, training activities and start-up activities, and on relocating or reorganising part or all of an entity to be recognised as an expense “as incurred”. Divergent interpretations have developed about when such expenses are “incurred”. This amendment seeks to clarify the meaning of ‘as incurred’ in this context.
- 134 It does that by stating that, in the case of the supply of goods, an expense should be recognised when the recipient of the goods “has a right to access those goods.” It goes on to state that examples of expenditure that should be recognised as an expense when it is incurred include “expenditure on advertising and promotional activities (including mail order catalogues).”
- 135 Some EFRAG members have concerns about this amendment. In their view the amendment touches on a very fundamental issue—the distinction between expenditure

that results in the creation of an asset and expenditure that represents an immediate expense—that is difficult to deal with adequately by simply including a few words in a standard. In their view, there is a risk that the amendment will give rise to anomalies that will affect the understandability and comparability, and perhaps even the representational faithfulness, of the information provided. For example, it could be argued that producing a mail order catalogue involves developing a product range and printing and distributing information about that product range and that the costs involved in the former might need to be accounted for in a different way from the latter costs. Others might argue that producing a mail order catalogue also involves the development of a distribution network, and that costs involved in developing that network should be accounted for in the same way as analogous arrangements, including retail websites and shop units. This concern was echoed in a number of the comments that EFRAG received in response to its invitation for comments on its draft technical assessment. Those respondents argued, inter alia, that the catalogues of mail order companies are comparable to ‘department stores at home’; in other words, they form part of the sales infrastructure, are analogous to website costs, and therefore involve internally-generated intangible assets that should be capitalised.

- 136 However, the majority of EFRAG members noted that the extent to which such catalogue costs are analogous to website costs and the extent to which such costs should be capitalised are issues that are specifically addressed by the IASB in new paragraph BC46H, which is inserted in the Basis for Conclusions of IAS 38. In that paragraph, the IASB points out that SIC-32 Intangible Assets—Web Site Costs “requires the cost of the content (to the extent that it is developed to advertise and promote products and services) to be recognised as an expense as it is incurred.” The IASB goes on to say that the majority of the content of a mail order catalogue is intended to advertise and promote products and services, and it concludes from that that mail order catalogue costs need to be expensed if the accounting is not to be based on the nature of the media used to deliver the content. The majority of EFRAG members accept these arguments, and therefore do not share the concerns raised. In their view the amendment will reduce uncertainty and therefore improve consistency and enhance comparability.

Amendment D: IAS 40 – Property under construction or development for future use as investment property

- 137 Through this amendment, the IASB has removed property under construction or development for future use as an investment property from the scope of IAS 16 *Property, Plant and Equipment* and included it within the scope of IAS 40 *Investment Property*. The intention behind this amendment is to permit entities to revalue such assets at fair value.
- 138 In addition, the IASB has amended IAS 40 to allow investment property under construction to be measured at cost if its fair value cannot be measured reliably, until such time as its fair value becomes reliably measurable or construction is completed (whichever comes earlier).
- 139 EFRAG believes that this amendment will remove an inconsistency in the accounting of investment property (namely the different accounting for assets under construction and assets under redevelopment) and therefore will improve accounting, as it allows companies to consistently apply one accounting model (i.e. cost or fair value) for the whole life time of an investment property. Comparability will thus be enhanced,

- 140 Some constituents are concerned about the reliability of fair value measures of investment property under construction. They note the amendment permits cost to be used when a reliable fair value is not available, but remain concerned that the overall effect of the amendment might be to introduce greater uncertainty into the accounting numbers. However, EFRAG believes that the ability to use cost when reliable fair values are not available is sufficient to address the reliability concerns that might otherwise arise.
- 141 EFRAG therefore believes that the amendment will result in a reduction in divergence in practice, thereby enhancing consistency and comparability of the information provided.

Does the accounting that results from the application of the amendment meet the criteria for EU endorsement?

- 142 As already mentioned, EFRAG has previously concluded that IFRSs affected by the amendments meet the endorsement criteria. Furthermore, as explained above, EFRAG believes that the amendments are consistent with the Framework, and its assessment is that the amendments are likely either to improve the financial information provided or have no effect on that information. In particular, EFRAG has concluded that the amendments 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.
- 143 EFRAG also concluded that there was no reason to believe that the information resulting from the application of the Amendments would be contrary to the true and fair view principle.

Conclusion

- 144 Having considered the various arguments described in this Appendix, EFRAG has concluded that the Amendments satisfy the criteria for endorsement in the EU.