esma European Securities and Markets Authority

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IASB
Hans Hoogervorst
Cannon Street 30
London EC4M 6XH
United Kingdom

The IASB's Exposure Draft *Annual Improvements to IFRSs 2010-2012 Cycle*

Dear Mr Hoogervorst,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to enhancing the protection of investors and promoting stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

ESMA has considered the IASB's Exposure Draft (ED) *Annual Improvements to IFRSs 2010-2012 Cycle*. ESMA thanks you for this opportunity to contribute to the IASB's due process. ESMA is pleased to provide you with the following comments aimed at improving the decision-usefulness of financial statements and the transparency and enforceability of IFRSs.

As we believe that the proposals set out in the ED contribute to improving financial reporting ESMA is generally supportive of the amendments in the ED. We however would like to draw the Board's attention to the following issues:

- ESMA supports clarifying paragraph 40 of IFRS 3 – *Business Combinations* but believes that the IASB should also propose consequential amendments to IAS 39 – *Financial Instruments: Recognition and Measurement*;

- IFRS 8 - *Operating Segments*: ESMA welcomes the proposed requirement to disclose the basis for aggregation operating segments but urges the Board to also consider further improvements to the IFRS literature on the definition of the Chief Operating Decision Maker (CODM) in the annual improvements project instead of delaying this to the post implementation review;

- IAS 1 – *Presentation of Financial Statements*: ESMA agrees with the clarification as it reinforces the classification principles of IAS 1 and provides additional guidance. ESMA would however encourage the Board to provide more guidance with respect to the meaning of ´loan facility´ as loans and credit facilities could take many different forms and terms. In addition, we propose to move some parts of the basis for conclusions to the standards to enhance the enforceability of the amendment;

- We agree *with most of the transition requir*ements and effective dates except for the IAS 1 and IAS 36 amendments. In our opinion comparative information should be provided to enable investors to evaluate, the developments during the year and the judgements affecting the impairment assessment.

We would be happy to discuss all or any of these issues further with you.

Yours sincerely,

Steven Maijoor
Chair ESMA

Julie Galbo
Chair ESMA's Corporate Reporting Standing Commitee

APPENDIX – ESMA's detailed answers to the questions in the IASB's *Annual Improvements to IFRSs 2010-2012 Cycle*

Question 1 – Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

Issue 1: IFRS 2 – Share-Based Payment: Definition of vesting conditions

1. ESMA supports the amendment as it clarifies the treatment of different elements of vesting conditions.

2. ESMA notes that the definition of a vesting condition in appendix A states that a performance condition may be a market condition. However, in the definition of a performance condition it is specified that the performance targets need to relate to the entity, its operations, or the price of its equity instruments. Thus the definition of a performance condition itself seems to be narrower then the definition of a vesting condition may imply. We believe that it would be better to move market conditions from the definition of a performance condition to the definition of a vesting condition.

Issue 2: IFRS 3 – Business Combinations: Accounting for contingent considerations in a business combination

3. ESMA supports to clarify paragraph 40 of IFRS 3 – *Business Combinations* as it removes uncertainty about the subsequent measurement of contingent considerations, when meeting the definition of a financial instrument. ESMA notes however that, by deleting the reference to 'other applicable IFRSs', IFRS 3 does not tell how to classify contingent considerations that do not meet the definition of financial instrument.

4. We note that different requirements apply for the subsequent measurement for contingent liabilities acquired in a business combination, i.e. IAS 37 – *Provisions, Contingent Liabilities and contingent Assets* or IAS 18 - *Revenue* (referring to IFRS 3 paragraph 56 and IFRS 3 paragraph BC 245). Is it intentional that subsequent measurement principles for contingent consideration and contingent liabilities will be different?

5. In ESMA's opinion the IASB should also propose consequential amendments to IAS 39 – *Financial Instruments: Recognition and Measurement* as the same issue applies. We note that the discussions on the first phase of IFRS 9 have been reopened recently and proposed changes with respect to impairment and hedge accounting have not been finalised. Entities that do not apply the standard early

should, on this issue, have comparable reporting with entities that do apply IFRS 9. We consequently would also support an earlier effective date than 1 January 2015.

Issue 3: IFRS 8 – Operating Segments: Aggregation of operating segments and reconciliation of the total of reportable segments' assets to entity's assets.

6. After conducting a review of the implementation of IFRS 8 – *Operating* Segments in 2011[1] ESMA recommended the IASB to make some improvement to IFRS 8 relating to 1) the aggregation of operating segments and 2) the identification of the chief operating decision maker (CODM). ESMA welcomes the proposal to include a more specific requirement in IFRS 8 to disclose the basis for aggregating operating segments.

7. ESMA however regrets that the IASB is not giving further consideration to its concerns on the definition of the CODM. It appears in practice that allocating resources and assessing performance may not always be carried out by the same persons or using the same set of information. It also appears in practice that some issuers have concluded that their CODM is their board of directors comprising both executive and independent non-executive directors. As operating segments are identified on the basis of information used by the CODM there is a risk that the operating segments disclosures are based on less detailed information included in board papers. The fact that non-executive directors are often identified as CODM, which appears to be contradictory to their governance responsibilities, indicates that preparers appear to be confused by the definition in the standard and this could easily be resolved by an annual improvements project.

8. It is important for ESMA that the standard should ensure that useful information is provided to investors allowing them to evaluate the nature and financial effects of the business activities in which a company engages and the economic environments in which it operates. This is achieved through issuers reporting the information used internally to make operating decisions. For all but the most straightforward of businesses this is unlikely to be based on the consolidated income statement which is the claim by issuers that report a single segment but, in fact, can result from confusion about the identification of the CODM.

9. ESMA notes that the IASB's intention is to include this issue in its post implementation review on IFRS 8 which still has to start. Considering the importance of segment reporting for investors ESMA would strongly encourage the IASB to deal with the issue through an annual improvements project.

[1] The report was published on 10 November 2011 on ESMA's website: http://www.esma.europa.eu/system/files/2011_372.pdf

Issue 4: IFRS 13 – Fair Value Measurement: Short-term receivables and payables

10. ESMA agrees with the proposal as we believe that the materiality concept in IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* as well as in IAS 1 – *Presentation of Financial Statements* and the Conceptual Framework provides the guidance for applying materiality to (requirements of) other standards and should not need to be included in other standards.

Issue 5: IAS 1 – Presentation of Financial Statement: Current/non-current classification of liabilities

11. ESMA agrees with the clarification that an entity should have the full discretion to refinance or roll over the debt with the same lender, on the same or similar terms, to classify the obligation as non-current. The amendment reinforces the classification principles of IAS 1 and provides additional guidance.

12. ESMA notes that the Board should provide more guidance with respect to the meaning of ′loan facility′ as loans and credit facilities could have many different forms and terms. It should be made explicit that the requirements of IAS 1 paragraph 73 apply to all non-current (financial) liabilities, including among others commercial papers.

13. In addition, ESMA believes that it would enhance the enforceability of the standard if the last sentence of BC 2 'terms are similar if the amendment of the terms would be expected to result in no substantial change to the rights and obligations of the parties to the loan facility' would be integrated in the standard.

Issue 6: IAS 7 – Statement of Cash Flows: Classification of interest paid that is capitalized as part of the cost of an asset

14. ESMA agrees with the amendment as it will reduce diversity in practice of the presentation of capitalized interest in the cash flow statements.

Issue 7: IAS 12 – Income Taxes: Recognition of deferred tax assets or unrealized losses

15. ESMA agrees with the amendments contained in paragraph 27A, paragraph 29(a)(i) and paragraph 30, as they clarify the application of assessing the recoverability –and recognition– of deferred tax assets.

16. Though ESMA welcomes the Board providing relevant and practical examples, we would like to note that the example included after paragraph 30A should better reflect the underlying principle in the case the instrument is hold until its maturity and in the case it is not.

17. As a last point, we would like to note that the amendment stems from an issue that was discussed earlier by the IFRS Interpretations Committee. ESMA believes that the amendments proposed by the Interpretations Committee in the IFRS IC Update were more straightforward and that the Board should re-consider using these suggestions.

Issue 8: IAS 16 and IAS 38 – Property, Plant and Equipment and intangible assets: Revaluation method – proportionate restatement of accumulated depreciation

18. ESMA agrees with the proposal to clarify that when revaluing property, plant and equipment and intangible assets, the restatement of the accumulated depreciation need not be proportionate to the change in the gross and net carrying amount of the asset. This will reduce diversity in practice.

Issue 9: IAS 24 – Related Party Disclosure: Key management personnel

19. ESMA welcomes the amendment. It will result in improved disclosures on executive pay in case management entities are used.

20. With regard to the proposed disclosure relief in paragraph 17A, we believe the relief may only be necessary in certain cases. For example, we can see the potential need for relief when a management entity provides key management services to many reporting entities, but we believe relief may not be necessary when a management entity provides key management services to only one or a few reporting entities. ESMA is concerned that some entities might avoid disclosures on management compensation through the use of management entities.

Issue 10: IAS 36 – Impairment of Assets: Harmonisation of disclosure for value in use and fair value less costs to sell

21. ESMA welcomes the proposal to align the disclosure requirements for fair value less cost to sell with disclosure requirements for the value in use approach when entities use a present value technique. As the valuation methodology is similar the disclosure requirements should – logically – also be similar.

Question 2 – Do you agree with the proposed transitional provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose?

22. ESMA agrees with the proposed transitional provisions and effective dates except for the following:

Issue 5: IAS 1 – Presentation of Financial Statement: Current/non-current classification of liabilities

23. ESMA disagrees with the proposal to exempt entities from adjusting the comparative information. It is important that investors are informed of the financial position of an entity on a consistent basis. Comparative information should be restated as not doing so runs the risk of creating a misleading impression of the development of the entity's financial position.

Issue 10: IAS 36 – Impairment of Assets: Harmonisation of disclosure for value in use and fair value less costs to sell

24. ESMA disagrees with the proposal to exempt entities from adjusting the comparative information. It is important that investors are informed of the financial position of an entity on a consistent basis. Comparative information should be restated as not doing so runs the risk of creating a misleading impression of the company's assets subject to the impairment provisions.