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Accounting Standards Committee of Germany

® IFRS-Fachausschuss

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Berlin, 16 August 2012

08. Sitzung IFRS-FA vom 31.08.2012
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Dear Hans,

Exposure Draft ED/2012/1 Annual Improvements to IFRSs 2010-2012 Cycle

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IASB Exposure Draft ED/2012/1 'Annual Improvements to IFRSs 2010-2012 Cycle'. We appreciate the opportunity to respond to the Exposure Draft under the fifth cycle of the Annual Improvements project.

In general, we agree with the proposals in the Exposure Draft. In some cases we provide additional comments that could lead to further improvements to the proposed amendments. Predominantly, we would like to raise the following issues for further consideration by the Board:

IFRS 3 *Business Combinations*: Accounting for contingent consideration in a business combination

In general, we agree with the Board's proposal. However, we believe that the IASB should make consequential amendments not only to IFRS 9 but also to IAS 39 *Financial Instruments: Recognition and Measurement*. Further, we suggest amending the wording of paragraph 40 of IFRS 3 to clarify that the obligation to pay contingent consideration may be classified as a non-financial liability. In addition, the proposed

paragraph 4.2.1(e) of IRFS 9 seems to be inconsistent with the accounting requirements of paragraph 5.7.1 in conjunction with paragraph 4.2.1(a) in cases, where liabilities for contingent considerations in a business combination meet the definition of derivatives.

We suggest bringing forward the effective date to 1 January 2014. Furthermore, we believe that it shall be allowed to apply the proposed amendment independently of an application of IFRS 9.

Finally, we would encourage the IASB to reconsider the entire concept of contingent consideration within the intended post implementation review of IFRS 3.

IAS 1 *Presentation of Financial Statements*: Current/non-current classification of liabilities

We partly agree with the Board's proposed amendment. While we fully support the proposed amendment to paragraph 73 clarifying that an existing obligation should be classified as non-current when it is refinanced or rolled over with the same lender, we have several concerns with respect to the proposed term 'same or similar terms'. We would encourage the IASB to reconsider the term 'same or similar terms' and to the ensure consistency with the corresponding terms used in IFRS 9. In addition, we suggest explaining the term 'same or similar' in the standard itself rather than in the Basis for Conclusions on IAS 1. Furthermore, we recommend improving the wording of the first sentence of paragraph 73 since it appears to be unclear.

Our detailed comments on the eleven proposed amendments are set out in the appendix to this letter.

If you would like to discuss any aspects of this comment letter in detail, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

Appendix

General questions – to be answered individually for each proposed amendment: **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? **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?

IFRS 2 *Share-based Payment*

Definition of 'vesting condition'

Question 1: We support the Board's intention to clarify the definition of 'vesting conditions' relating to share-based payments. We acknowledge that there is a lack of clarity in the current definitions of 'performance conditions' and 'service conditions' that are incorporated in the definition of 'vesting conditions' in IFRS 2. Within the proposed revision the Board addresses certain specific concerns that have been raised about these definitions. However, we think that addressing several specific cases within a standard seems to be inconsistent with a principle-based approach. Disadvantages of a case-specific approach are an increased complexity and a still incomprehensive definition that might require further contentious case-specific changes to IFRS 2.

Question 2: We agree with the Board's proposal.

IFRS 3 *Business Combinations*

Accounting for contingent consideration in a business combination

Question 1: In general, we agree with the Board's proposal to clarify the accounting for contingent consideration arising from business combinations. The IASB's ra-

tionale for this amendment, as given in the Basis for Conclusions, is convincing. Specifically, we support removing from IFRS 3 all the references to other IFRSs and instead creating a provision within IFRS 3 which clarifies the classification and the subsequent measurement of all contingent considerations in a business combination.

However, entities that are not applying IFRS 9 early should benefit from the proposed amendments as well. For this reason, we believe that the IASB should make consequential amendments not only to IFRS 9 but also to IAS 39 *Financial Instruments: Recognition and Measurement*.

Furthermore, the wording of paragraph 40 as proposed is not clear as to whether the obligation to pay contingent consideration may be classified as a non-financial liability. Therefore, we recommend adding a reference to this within the IFRS 3. Furthermore, we suggest amending the first sentence of paragraph 40 of IFRS 3 as follows: "The acquirer shall classify an obligation to ~~pay~~ fulfill contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of IAS 32 *Financial Instruments: Presentation*".

In addition, we question whether the proposed paragraph 4.2.1(e) of IRFS 9 is consistent with the accounting requirements of paragraph 5.7.1 in conjunction with paragraph 4.2.1(a) in cases, where liabilities for contingent consideration in a business combination meet the definition of derivatives. The proposed paragraph 4.2.1(e) requires changes in the fair value of contingent consideration in a business combination to be presented in accordance with paragraphs 5.7.7-5.7.8 of IFRS 9. According to paragraph 5.7.7(a) those changes in the fair value that are attributable to changes in the credit risk of a financial liability shall be recognised in other comprehensive income. At the same time, these changes in the fair value shall be presented in profit or loss, if a relevant contingent consideration meets the definition of a derivative (paragraph 5.7.1 in conjunction with paragraph 4.2.1(a)). That this can be the case follows from paragraph BC354 on IFRS 3, according to which many obligations for contingent consideration classified as liabilities meet the definition of derivatives.We would like to point out that the whole concept of accounting for contingent consideration in a business combination as prescribed in IFRS 3 is criticized by constituents.

Therefore, we would encourage the IASB to reconsider the entire concept within the intended post implementation review of IFRS 3. In this context, the accounting for contingent payments for the separate purchase of property, plant and equipment and intangible assets which is currently being discussed by the IFRS Interpretation Committee should be made consistent with the accounting for contingent consideration in a business combination. Hence, we believe that the Board should address the accounting of contingent considerations in a holistic manner.

We concur with the IASB's intention to rectify perceived inconsistencies with respect to the accounting for contingent consideration in a business combination through the Annual Improvements project because it adds clarity on the issue on a timely basis. However, we believe that any future amendments to IFRS 3 would best be considered in connection with the IASB's post implementation review of this standard rather than in the Annual Improvements project.

<u>Question 2</u>: We disagree with the Board's proposal.

As a consequence of our suggestion regarding the consequential amendments to IAS 39 as described in our response to question 1 above, we suggest the following amendments to the proposed effective date:

- bringing forward the effective date of the proposed amendments to 1 January 2014,
- deleting the last part of the sentence of the proposed IFRS 3.64G "[…] ~~and at the same time apply IFRS 9 *Financial Instruments* (as amended by *Annual Improvements to IFRSs 201-2012 Cycle*)~~",
- deleting the last part of the sentence of the proposed IFRS 9.7.1.4 "[…] ~~and at the same time apply IFRS 3 *Business Combinations* (as amended by *Annual Improvements to IFRSs 201-2012 Cycle*)~~",
- deleting the last sentence of paragraph BC7 on IFRS 3 "~~In addition, the Board thinks that the proposed amendment should not be applied before IFRS 9 (2010) because of the proposed consequential amendment to that IFRS~~",
- proposing an effective date in IAS 39 by analogy with the proposed effective date in IFRS 9.

IFRS 8 *Operating Segments*

Aggregation of operating segments

Question 1: We partly agree with the proposal to require entities to state the basis for the aggregation of entity's operating segments. We acknowledge the IASB's rationale for this amendment that is to provide users with the understanding of how operating segments have been aggregated.

Nevertheless, we believe that the additional disclosure requirement should only include a brief description of the operating segments that have been aggregated and an explanation of how the aggregation criteria of IFRS 8.12 have been met. In our view, it should be within the management's discretion to specify which qualitative or quantitative characteristics are appropriate to be disclosed in order to inform the users about the factors considered in aggregating the operating segments. Examples for specific economic characteristics provided in the proposed paragraph 22(aa) in brackets ("profit margin spreads, sales growth rates etc") indicate only quantitative information to be disclosed. Accordingly, we suggest either deleting the text in brackets or adding examples for quantitative criteria.

Finally, we believe that any future amendments to IFRS 8 would best be considered in connection with the IASB's post implementation review of this standard rather than in the Annual Improvements project.

Question 2: We agree with the Board's proposal.

IFRS 8 *Operating Segments*

Reconciliation of the total of the reportable segments' assets to the entity's assets

Question 1: We agree with the Board's proposal.

Question 2: We agree with the Board's proposal.

IFRS 13 *Fair Value Measurement*

Short-term receivables and payables

Question 1: The Board proposes amending the Basis for Conclusions on IFRS 13 without amending the standard correspondingly. In our view amending the standard itself would generally be a preferable approach.

With respect to the proposed amendment, we do not see the need for a clarification that the deletion of B5.4.12 of IFRS 9 and AG79 of IAS 39 did not intend to change the practical expedient to measure short-term receivables and payables with no stated interest rate at invoice amounts without discounting, when the effect of not discounting is immaterial. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* addresses materiality in applying accounting policies und thus, already contains such a practical expedient. There is no need for case-by-case provisions regarding the consideration of materiality. Conversely, the explicit guidance on the accounting treatment of issues that are not material within the several standards or the accompanying documents might falsely imply that the materiality principle should not be applied, if not explicitly referred to in the related standard.

Furthermore, we question whether the proposed amendment is consistent with the practical expedient as proposed in paragraph 60 of the IASB's ED/2011/6 *Revenues from Contracts with Customers*. The measurement of short-term receivables and payables with no stated interest rate without discounting is only allowed, if the effect of not discounting is immaterial. However, the practical expedient of paragraph 60 of ED/2011/6 is not limited to cases where the time value of money is immaterial. This might result in different accounting treatments for economically similar issues.

Question 2: Not applicable, since the proposed amendment regards the Basis for Conclusions.

IAS 1 *Presentation of Financial Statements*

Current/non-current classification of liabilities

Question 1: We partly agree with the Board's proposed amendment. We acknowledge that there is currently diversity in practice on the classification of liabilities when

different terms apply. Furthermore, there is a perceived inconsistency between the current/non-current classification of liabilities in IAS 1 and derecognition guidance for financial liabilities given in IFRS 9.

Therefore, we fully agree with the proposed amendment to paragraph 73 of IAS 1 related to the classification of a liability as non-current, if it is refinanced or rolled over under the existing loan facility with the same lender. However, with respect to the proposed term ‘same or similar terms’, we have the following concerns.

The term ‘same or similar terms’ is ambiguous.

For example, it might not be clear how to classify a loan in case the interest rate agreed by the parties involved depends on the entity’s ranking:

- On the one hand, the deterioration of the entity’s ranking at the time of a loan rollover leads to increased interest payments, which would indicate that the terms are not the same.

- On the other hand, since the connection of the interest rate to the entity’s ranking is part of the loan conditions agreed already at the inception of this loan, it could be concluded that the same terms apply when rolling over this loan.

It might also not be clear whether the terms of a fixed-interest loan can be assessed as similar when, in case of refinancing under the existing loan facilities, the interest rate of this loan will be adapted to the market.

In this context, the purpose of the classification of liabilities as current or non-current in IAS 1 should be considered, which is to provide information about the entity’s long term liquidity situation independent of its creditworthiness or about the same or similar credit conditions.

In addition, we do not support introducing new terminology in IAS 1. As noted in the proposed Basis for Conclusions on IAS 1, one of the Board’s intentions for the proposed amendment is to remove inconsistencies between IAS 1 and IFRS 9 regarding the classification / derecognition of financial liabilities when different loan terms apply. To achieve this, we think it is favourable either to use the same wording in both stan-

dards or to explain whether several terms used in both standards ('same or similar terms', 'no substantial change to the rights and obligations', 'substantial modification' and 'substantially different terms') have the same meaning. Further, we question whether the '10 per cent extinguishment test' as described in B 3.3.6 of IFRS 9 and AG 62 of IAS 39 can be used when assessing the similarity of the loan terms.

Therefore, we would encourage the IASB to reconsider the term 'same or similar terms' and to the ensure consistency with the terms used in IFRS 9. Furthermore, we suggest explaining this term in the standard itself rather than in the Basis for Conclusions on IAS 1.

Furthermore, we believe that the wording of the first sentence of paragraph 73 of IAS 1 should be improved. Firstly, it might not be clear whether the terms should be assessed as similar when only a part of an existing obligation is expected to be refinanced or rolled over. Secondly, the word 'discretion' implies a judgment factor which may not be an intention of the requirement of this paragraph. Accordingly, we would suggest amending the wording of the proposed first sentence of paragraph 73 of IAS 1 as follows:

"If an entity expects, and has ~~the discretion~~ <u>the right and the ability at the reporting date</u> to refinance or roll over an obligation <u>or a part of it</u> for at least twelve months after the reporting period under an existing loan facility with the same lender, on the same or similar terms, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period."

Finally, the reference in BC1 and in the footnote to BC1 to paragraph 3.2.2 of IFRS 9 in the proposed amendment is not correct. It should be 3.<u>3</u>.2.

<u>Question 2</u>: We agree with the Board's proposal.

IAS 7 *Statement of Cash Flows*

Interest paid that is capitalised

<u>Question 1</u>: We agree with the Board's proposal.

Question 2: We agree with the Board's proposal.

IAS 12 *Income Taxes*

Recognition of deferred tax assets for unrealised losses

Question 1: We agree with the Board's proposal.

Question 2: We agree with the Board's proposal.

IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*

Revaluation method—proportionate restatement of accumulated depreciation

Question 1: We agree with the Board's proposal.

Question 2: We agree with the Board's proposal.

IAS 24 *Related Party Disclosures*

Key management personnel

Question 1: We agree with the Board's proposal.

Question 2: We agree with the Board's proposal.

IAS 36 *Impairment of Assets*

Harmonisation of disclosures for value in use and fair value less costs of disposal

Question 1: We agree with the Board's proposal.

Question 2: We agree with the Board's proposal.