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Dr. Andreas Barckow
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Our ref BOD/288

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Dear Dr. Barckow

Comment letter on the Exposure Draft in relation to the Annual Improvements to IFRS Accounting Standards – Volume 11

We appreciate the opportunity to comment on the International Accounting Standards Board's (IASB) Exposure Draft on the *Annual Improvements to IFRS Accounting Standards* – *Volume 11*, published in September 2023. We have consulted with, and this letter represents the views of, the KPMG network.

We appreciate the IASB's efforts to propose narrow-scope amendments to IFRS Accounting Standards and accompanying guidance as part of its periodic maintenance of the Accounting Standards.

We broadly agree with the proposals. However, we have varying concerns relating to specific sections of the Exposure Draft as shown in the appendix to this letter, which contains our detailed responses to the questions raised. In particular, we disagree with the proposed amendments to IFRS 9 *Financial Instruments* relating to derecognition of a lease liability. We recommend that this issue be addressed as part of a more comprehensive project to clarify the interaction of IFRS 9 and IFRS 16 *Leases* for both lessors and lessees, rather than through the annual improvements process.

Please contact Brian O'Donovan at brian.odonovan@kpmgifrg.com or Uni Choi at uni.choi@kpmg.co.uk if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix

Question raised by the Exposure Draft:

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

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

KPMG's response to the question above in relation to:

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

  We agree with the proposed amendments to paragraphs B5 and B6 of IFRS 1. The replacement of the word *'condition'* with *'qualifying criteria'* in paragraph B6 of IFRS 1 and the addition of a cross reference to IFRS 9 in paragraph B5 of IFRS 1 would improve consistency and understandability of both accounting standards.

- **Proposed amendments to IFRS 7 *Financial Instruments: Disclosures* and *Guidance on implementing IFRS 7 Financial Instruments: Disclosures***

  — Gain or loss on derecognition

  We agree with the proposed amendments to paragraph B38 of IFRS 7. The replacement of the reference to paragraph 27A of IFRS 7 with the reference to paragraphs 72-73 of IFRS 13 would update an obsolete cross-reference.

  — Disclosure of deferred difference between fair value and transaction price

  We agree with the proposed amendments to paragraph IG14 of IFRS 7. The amendments would improve consistency with paragraph 28 of IFRS 7.

  — Credit risk disclosures

  In principle, we agree that it would be useful to add a clarifying statement in paragraph IG1. However, leaving the specific identification in paragraph IG 20B that explains which parts of paragraphs 35H – 35I of IFRS 7 it does not illustrate could raise the same question about paragraph IG 20C of IFRS 7, which led to these amendments.

  We would recommend the IASB either:

  (i) remove from paragraph IG 20B the specific identification as to which parts of IFRS 7 it does not illustrate and add a clarifying statement in IG 1; or

(ii) use a standard approach in each paragraph including, but not limited to, IG 20C – i.e. include in every paragraph the current wording in IG 20B that identifies the disclosures that are not illustrated.

In addition, the proposed amendments to paragraph IG1 make a generic statement that, collectively, not all requirements in IFRS 7 are illustrated by the guidance paragraphs that follow. However, it would more accurately reflect the IASB's intention if it said that in the IG paragraphs that follow, not all the specific requirements of the paragraph that is referenced as being illustrated (e.g. paragraph 35M of IFRS 7 in paragraph IG 20C) are necessarily illustrated. If it were made clearer, there would be no need to draw attention to the fact that in paragraph IG 20B there are omissions from the illustration (in respect of POCI assets) that are specific to paragraphs 35H and 35I of IFRS 7. We recommend the IASB reconsider the drafting, especially if they were to follow the approach (i) we explained above.

- **Proposed amendments to IFRS 9 *Financial Instruments***

— Transaction price

We welcome and are supportive of the proposed amendments as shown on page 22 and 24 of the Exposure Draft. The amendments to paragraph 5.1.3 and Appendix A of IFRS 9 will improve the understandability of the standard.

— Derecognition of lease liability

We disagree with the proposal to amend paragraph 2.1(b)(ii) of IFRS 9 to add a cross-reference to paragraph 3.3.3 of that Standard, for the reasons set out below.

There is an acknowledged practice issue regarding the interaction between the lease modification guidance for lessees in IFRS 16 and the derecognition guidance for financial liabilities in IFRS 9. The ED states that the proposed amendment would "resolve potential confusion". In fact, the proposed amendment would introduce a clear conflict between IFRS 16 and the paragraphs of IFRS 9 that a lessee is required to apply.

Paragraph 46 of IFRS 16 states that a lease modification, that is not accounted for as a separate lease, results in an adjustment to the right-of-use asset. This applies to all such lease modifications, including those that result in derecognition of part of the lease liability, unless the right-of-use asset has been reduced to nil. In contrast, paragraph 3.3.3 of IFRS 9 states that a gain or loss arising on derecognition of a financial liability is recognised in profit or loss.

At present, if a change to a lease agreement meets the definition of a lease modification and involves the derecognition of part of the lease liability, then it is possible for the lessee to comply with both IFRS 16 and the paragraphs of IFRS 9 that the lessee is required to apply. This is because the lessee is **not** required to apply paragraph 3.3.3 of IFRS 9.

We note that paragraph BC2 of the ED asserts that "the IASB intended a lessee to apply … paragraph 3.3.3 and the lack of a cross-reference … was an oversight". We have not found any evidence to support this assertion. Rather, paragraphs BC200-205 of IFRS 16 suggest that it was the clear intention of the IASB that a change in the consideration for the lease would result in an adjustment to the right-of-use asset, not a gain or loss on derecognition. Specifically, BC203(b) of IFRS 16 states:

"For all other lease modifications, a lessee should make a corresponding adjustment to the carrying amount of the right-of-use asset… For lease modifications that change the consideration for the lease, the adjustment to the right-of-use asset effectively represents a change in the cost of the right-of-use asset as a result of the modification."

Rather than amending IFRS 9 to make it impossible for a lessee to comply with both IFRS 16 and the paragraphs of IFRS 9 that it is required to apply, we recommend that the IASB consider more broadly the interaction of IFRS 9 and IFRS 16. This would be beyond the scope of an Annual Improvement.

Should the IASB decide to move ahead with an amendment to IFRS 9 in this cycle of the annual improvements process, we believe that a narrower amendment should be made, such as specifying that:

- IFRS 9 applies to derecognition of lease liabilities where cancellation takes effect immediately, either via transfer or termination of the lease;
- IFRS 9 applies, except when the derecognition arises due to a lease modification; or
- IFRS 9.3.3.3 applies, except when IFRS 16 requires the right-of-use asset to be adjusted.

Alternatively, if the IASB believes that a lessee should not apply the lease modification guidance to a sub-set of lease modifications – for example lease modifications that involve only the forgiveness of specific lease payments that remain unpaid after their due date – then IFRS 16 should be amended.

- **Proposed amendments to IFRS 10 *Consolidated Financial Statements***

— Determination of a 'de facto agent'

We agree with the proposed amendment to IFRS 10 to remove from paragraph B74 an inconsistency with paragraph B73. To clarify the intended meaning of the new sentence it may be helpful to add the word 'also' so it makes clear that this is an additional way an entity could have a de facto agent relationship.

*"….*A party might [also] be a de facto agent when those that direct the activities of the investor have the ability to direct that party to act on the investor's behalf*…."*

- **Proposed amendments to IAS 7 *Statement of Cash Flows***

  — Cost method

  We agree with the proposed amendments to paragraph 37 of IAS 7 to replace the reference to ‘cost method’ with ‘at cost’. The replacement would remove a reference that is no longer defined in IFRS Accounting Standards.