

EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENT TO IAS 39 and IFRS 7 "RECLASSIFICATIONS OF FINANCIAL ASSETS – EFFECTIVE DATE AND TRANSITION"

INTRODUCTION

- 1 Following discussions in 2007 between the various parties involved in the EU endorsement process, it was decided that more extensive information than hitherto should 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 Amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* "Reclassification of Financial Assets – Effective Date and Transition" (the Amendment).
- 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 Amendment, 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 Amendment in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments and information 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.

A SUMMARY OF THE AMENDMENT

- 4 This Amendment clarifies the effective date and transition requirements of the amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* "Reclassification of Financial Assets"

issued on 13 October 2008 (the October amendment). EFRAG recommended the October amendment for endorsement in the EU, and it has since been endorsed.

- 5 The October amendment permitted entities in certain circumstances to reclassify non-derivative financial assets out of the held-for-trading category and the available-for-sale category at fair value on the date of reclassification. Such reclassifications are to be carried out on a real-time basis (ie at the current date), except that the amendment allows some backdating to 1 July 2008 as part of the transitional arrangements. The Amendment clarifies the degree of backdating to be allowed.
- 6 The IASB's intention had been to allow reclassifications to be backdated as long as (a) the reclassification is made before 1 November 2008 and (b) the reclassification is not backdated to a date before 1 July 2008.
- 7 However, shortly after the October 2008 amendment was issued it became apparent that the effective date and the transitional requirements of the October amendment had been ambiguously drafted and as a result did not fully reflect the IASB's intentions. That is because the October amendment stated that "any reclassification of a financial asset made in periods beginning on or after 1 November 2008 shall take effect only from the date when the reclassification is made" and this wording has been interpreted by some to mean that reclassifications made in periods starting on or before 31 October 2008 can be backdated to 1 July 2008.
- 8 On 24 October 2008 the IASB clarified its intentions with regard to the effective date and the transitional requirements in the October 2008 issue of the IASB Update, an official IASB report on its deliberations and decisions taken during the IASB public meetings. The Amendment, which was issued on 27 November 2008, formally incorporates that clarification into IFRS.

EFRAG'S INITIAL ANALYSIS OF THE COSTS AND BENEFITS OF THE CLARIFICATION

- 9 In carrying out its initial assessment, EFRAG took the view that it was not appropriate to evaluate the Amendment on a standalone basis; rather, it should be evaluated together with the October amendment. The October amendment was issued following an urgent request from Europe. Indeed, because of the urgency that had been attached to the request made to the IASB, the IASB had no choice if the request was to be met but to put aside its normal due process and issue a final amendment without any prior public consultation. This action was without precedent. The IASB has a due process for very good reasons. One of those reasons is that it makes it less likely that the IASB will include ambiguous wording in its final documents. Requesting urgent action from the IASB and therefore asking it to put aside its due process meant accepting the risk that drafting ambiguities might arise in the resulting standard and, if any did arise, that it should be acceptable for the IASB to clarify the drafting.
- 10 EFRAG has therefore considered to what extent its assessment would have been different had this Amendment been part of the October amendment. EFRAG's tentative assessment was that its assessment would not have been different. Indeed, the effective date and transition arrangements in the October amendment were described to EFRAG at the meeting at which the October amendment was evaluated in terms that were consistent with this Amendment. The results of the

initial assessment can be summarised as follows. This Amendment considered together with the October amendment:

- (a) will involve preparers in some additional costs to make the reclassifications, although reclassification is optional so those costs are taken on voluntarily;
 - (b) will involve users in some insignificant additional analysis costs; and
 - (c) will involve benefits that are likely to exceed those costs.
- 11 EFRAG published its initial assessment of the costs and benefits of implementing this Amendment and the October amendment in the EU and supporting analysis on 8 December 2008 and invited comment on it until 8 January 2009. In response, all but one of the letters commenting on EFRAG's initial assessment agreed with it. The other letter stated that their experience was that costs involved for preparers in implementing the October amendment are not insignificant.

EFRAG's FINAL ANALYSIS OF THE COSTS AND BENEFITS OF THE AMENDMENT

- 12 Based on its initial analysis and comment letters received in response to that analysis, EFRAG's final analysis of the costs and benefits of the Amendment is presented in the paragraphs below.

Costs and benefits for preparers

- 13 When EFRAG assessed the October amendment, it noted that there would be costs involved for preparers in making the reclassifications although, as reclassification is optional, those costs are voluntarily incurred. Those costs can be significant in some cases. However, since the implementation of the October amendment is voluntary, EFRAG expects that preparers will implement the October amendment only if they believe that the benefits of the implementation for them will exceed the costs involved. EFRAG believes that the Amendment does not change this assessment in any way.

Possible implications for those who had been interpreting the effective date and transitional requirements of the October amendment differently

- 14 One obvious implication of the Amendment is that it will not be possible to make reclassifications in the future and backdate them, perhaps to 1 July 2008. This will disrupt some entities' plans. Indeed, some entities might have deliberately chosen not to rush their reclassifications so that they were made before 1 November 2008 because they thought they had plenty of time to do them and still backdate them. EFRAG notes however that the IASB clarified its intentions as early as 24 October when it issued IASB Update.
- 15 Another implication of the Amendment is that any reclassification made since 31 October 2008 that has been backdated will need to be reversed and replaced by a current date reclassification. However, in EFRAG's view, the IASB's decision to issue a clarification of the problematical wording on 24 October 2008, and its decision to issue this Amendment as soon as possible thereafter, has minimised this need.

Costs and benefits for users

- 16 When EFRAG assessed the October amendment, it also noted that reclassifications will make the financial statements more complex in some regards.
- (a) Some users believe reclassifications will make financial statements more relevant and understandable, and for those users it is probably the case that the benefits arising from increased relevance and understandability offset the increased complexity.
 - (b) Some users however do not believe the October amendment will make the financial statements more relevant; many of these users will wish to eliminate the effect of reclassifications made in accordance with the October amendment, thus incurring additional costs in performing their analysis. EFRAG notes however that the additional disclosures that the October amendment requires entities to provide if they reclassify certain instruments should help to minimise those additional analysis costs for these users.

EFRAG believes that the Amendment does not change this assessment.

Overall assessment

- 17 On balance, EFRAG believes that the benefits that would arise from the October amendment and this Amendment were likely to exceed costs involved.

Stig Enevoldsen
EFRAG, Chairman
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