EFRAG

European Financial Reporting Advisory Group

The costs and benefits of implementing Severe Hyperinflation and Removal of fixed dates for first-time adopters (Amendments to IFRS 1)

Introduction

1 Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 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 *Severe Hyperinflation and Removal of fixed dates for first-time adopters (Amendments to IFRS 1)* ('the Amendments').

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 Amendments, 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 that EFRAG has carried out seem to confirm this. Therefore, as explained more fully in the main sections of this report, the approach that EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the Amendments 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 also carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB 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 AMENDMENTS

Background

4 IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides guidance on the initial adoption of IFRS and, in doing so, provides a limited number

of exemptions and exceptions as practical expedients to deal with certain implementation issues that arise on first-time adoption.

Severe hyperinflation

5 When the functional currency of an entity is the currency of a hyperinflationary economy, circumstances of 'severe hyperinflation' may make IAS 29 *Financial Reporting in Hyperinflationary Economies* difficult or impossible to apply. The measurement of the assets and liabilities of a reporting entity under such circumstances in accordance with IFRSs may not be reliable. As a result, such an entity may be unable to prepare financial statements under IFRSs for a period of time.

6 Once the conditions of severe hyperinflation pass, a reporting entity can resume reporting under IFRSs but would be considered a first-time adopter of IFRSs. However, there was no specific guidance in IFRSs to help a reporting entity resume preparation of financial statements under IFRSs, once the conditions of severe hyperinflation pass.

<u>What has changed?</u>

7 The IASB amended IFRS 1 to add an exemption that allows an entity that had been subject to severe hyperinflation to use fair value as the deemed cost of its assets and liabilities in its opening IFRS statement of financial position. The Amendment is available to reporting entities emerging from a period of severe hyperinflation that had not applied IFRSs in the past.

8 A currency is subject to severe hyperinflation when:

(a) a reliable general price index is not available to all entities with transactions and balances in the currency; and

(b) exchangeability between the currency and a relatively stable foreign currency does not exist.

9 An entity that applies the exemption should disclose the facts and circumstances regarding their functional currency that lead the entity to apply the exemption.

10 The functional currency of an entity ceases to be subject to severe hyperinflation on the functional currency normalisation date, which is the date on which:

(a) the functional currency no longer has either, or both, of the two characteristics which determine a situation of severe hyperinflation explained above; or

(b) there is a change in the entity's functional currency to a currency that is not subject to severe hyperinflation.

11 The exemption can be applied to assets and liabilities that were held before the functional currency normalisation date, but not to other assets and liabilities held by the reporting entity at the date of transition to IFRSs. In cases when the parent company is subject to a situation of severe hyperinflation but not its subsidiary, the subsidiary would not be permitted to apply the exemption.

12 The Amendments permit a comparative period shorter than 12 months if the functional currency normalisation date would fall within a 12-month comparative

period provided that a complete set of financial statements is provided for that shorter comparative period.

13 Adjustments should be recognised directly at the transition date in retained earnings in accordance with paragraph 11 of IFRS 1.

Removal of fixed dates

14 Paragraph B2 in Appendix B of IFRS 1 provides an exception from full retrospective application of the derecognition requirements of financial assets and liabilities in IAS 39. The exception states that a first-time adopter of IFRS shall apply the derecognition requirements of IAS 39 prospectively for transactions that occur on or after 1 January 2004. Similarly, paragraph D20 in Appendix D of IFRS 1 allows a first-time adopter of IFRSs to apply the requirements of paragraphs AG76 and AG76A of IAS 39 prospectively to transactions entered into after 25 October 2002 or 1 January 2004.

15 The fixed dates in IFRS 1 result in exceptions and exemptions that are largely irrelevant because they only apply to transactions that occurred before 2004.

<u>What has changed?</u>

16 The IASB decided to replace the references to those fixed dates in IFRS 1 with references to the date of transition.

When do the Amendments become effective?

17 The Amendments will apply for annual periods beginning on or after 1 July 2011.

EFRAG's initial analysis of the costs and benefits of the Amendments

18 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing the Amendments, both in year one and in subsequent years. The results of EFRAG's initial assessment can be summarised as follows:

(a) *Costs* – EFRAG's initial assessment was that the Amendments were likely to reduce the one-off costs at the date of transition to IFRSs and would not impact the ongoing costs of applying IFRS for preparers and would not significantly affect the costs for users.

(b) *Benefits* – EFRAG's initial assessment was that the Amendments would result in benefits for preparers and users.

19 EFRAG published its initial assessment and supporting analysis on 8 December 2011. It invited comments on the material by 8 January 2012. In response, EFRAG received six comment letters. Two respondents agreed with EFRAG's assessment of the benefits of implementing the Amendments and the associated costs involved for users and preparers. The remaining four respondents did not comment specifically on EFRAG's initial assessment of the costs and benefits of implementing the Amendments in the EU, but supported EFRAG's recommendation that the Amendments be adopted for use in Europe.

EFRAG's final analysis of the costs and benefits of the Amendments

20 Based on its initial analysis and stakeholders' views on that analysis, EFRAG's detailed final analysis of the costs and benefits of the Amendments is presented in the paragraphs below.

Cost for preparers

21 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments.

22 EFRAG notes that the Amendments allow an entity emerging from severe hyperinflation to use the fair value on the date of transition to IFRSs as the deemed cost for certain assets and liabilities in the opening IFRS statement of financial position. To the extent that it is impossible or prohibitively costly to apply retrospectively IAS 29, preparers are expected to apply the exemption and to benefit from the relief offered by it.

23 The removal of the fixed dates in IFRS 1 provides relief to first-time adopters of IFRSs as they are not required to reconstruct transactions that occurred before their date of transition to IFRSs, because the Amendments allow for a prospective rather than a fully retrospective application of some requirements of IAS 39 at the date of transition.

24 Overall, EFRAG's assessment is that the Amendments are likely to reduce the one-off costs at the date of transition to IFRSs and do not impact the ongoing costs of applying IFRSs for preparers.

Costs for users

25 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments.

26 EFRAG is not aware of any aspect of the Amendments that will increase the costs users will incur in analysing the financial statements.

27 For entities emerging from severe hyperinflation there will be an adjustment in retained earnings at the transition date and the comparative period could be less than 12 months if the functional currency normalisation date falls within a 12-month comparative period. EFRAG notes that both facts have to be disclosed or explained in the notes to the financial statements in accordance with paragraphs 31C and D30 of the Amendments and should not result in any additional costs for users.

28 Overall, EFRAG's assessment is that the Amendments will not significantly affect the costs for users.

Benefits for preparers and users

29 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments.

30 As EFRAG has noted for other amendments to IFRS 1, the Amendments provide benefits to preparers and users because they facilitate the adoption of IFRSs. As a result, the Amendments enhance comparability.

31 For entities emerging from severe hyperinflation, the measurement at fair value at the transition date and the use of that fair value as the deemed cost results in information that is more relevant and reliable when compared with information based on the application of IAS 29 over a period during which a reliable price index was not available and the local currency was not exchangeable. This fact also enhances relevance, reliability, comparability and it is a benefit for users in order to understand better the financial statements of the reporting entity.

Conclusion

32 Overall, EFRAG's assessment is that the benefits to be derived from implementing the Amendments are likely to outweigh the costs involved.

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