EFRAG

European Financial Reporting Advisory Group

The costs and benefits of implementing the *Annual Improvements to IFRSS 2010-2012 Cycle*

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 the *Annual Improvements to IFRSS 2010-2012 Cycle* ('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

4 The IASB has adopted an annual process to deal with non-urgent, but necessary, amendments to IFRSs (the annual improvements process). Issues dealt with in this process arise from matters raised by the International Financial Reporting Standards Interpretations Committee and suggestions from staff or practitioners, and focus on areas of inconsistency in IFRSs or where clarification of wording is required.

5 This assessment deals with the amendments made by the International Accounting Standards Boards within the annual improvements project which were included in the standard published on 12 December 2013 *Annual Improvements to*

IFRSs 2010-2012 Cycle (henceforth referred to as 'the Amendments') together with the related Basis for Conclusions. The Amendments were issued in draft form in May 2012 in the Exposure Draft ED/2012/1 *Annual Improvements to IFRSs 2010-2012 Cycle*.

6 This assessment does not cover the amendments to IFRS 13 *Fair Value Measurement*, as they only affect the basis for conclusions of that Standard, which are not part of IFRS as adopted by the European Union. In addition, *Annual Improvements to IFRSs 2010-2012 Cycle* include consequential amendments to IFRS 9 *Financial Instruments*, which has not yet been endorsed in the EU.

7 Set out below is a description of each of the amendments made to current Standards.

IFRS 2 Share-Based Payment: Definition of vesting conditions

8 The Amendments to IFRS 2 *Share-Based Payment* clarify the definition of a vesting condition in IFRS 2 *Share-based Payment* to ensure the consistent classification of conditions attached to a share-based payment plans. In addition, the Amendments to IFRS 2 introduce separate definitions of performance conditions and service conditions.

9 In addition, the Amendments to IFRS 2 clarify some issues that had been raised by constituents in applying current definition of vesting condition in IFRS 2, namely:

(a) *whether a performance target can be set by reference to the price (or value) of another entity (or entities) that is (are) within the group*: the Amendments to IFRS 2 clarify that within the context of a share-based payment transaction between entities in the same group, a performance target can be defined by the price (or value) of the equity instruments of another entity in that group. The definition of market condition was also amended to clarify this.

(b) *whether a performance target that refers to a longer period than the required service period may constitute a performance condition*: the Amendments to IFRS 2 clarify that the period over which the performance target is achieved should not extend beyond the service period. In addition, under the Amendments to IFRS 2 the start of the period of achieving the performance target could begin before the service period, provided that the period over which the performance target is achieved substantially coincides with the service period.

(c) *whether the specified period of service that the counterparty is required to complete can be either implicit or explicit*: the Amendments to IFRS 2 state that a performance condition has an explicit or implicit service requirement and a non-vesting condition does not. Therefore, a performance condition needs to have both a performance target and a service requirement that can be implicit or explicit.

(d) *whether a performance target needs to be influenced by an employee*: the Amendments to IFRS 2 make clear that a performance target needs to be defined by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments (including shares and share options). In addition, the Amendment clarify the definition of performance condition to state that a performance target may relate either to the performance of the

entity as a whole or to some part of it, such as a division or an individual employee.

(e) *whether a share market index target may constitute a performance condition or a non-vesting condition*: the Amendments to IFRS 2 clarify that a share market index is a non-vesting condition. Therefore, a share market index does not only reflect the performance of an entity but, instead, also reflects the performance of other entities outside the group.

(f) *whether the definition of performance condition should indicate that it includes a market condition*: the Amendments to IFRS 2 clarify within the definition of performance condition that performance conditions are either market conditions (e.g. the price of the entity's equity instruments) or non-market conditions (e.g. the entity's own operations).

10 The Amendments to IFRS 2 should be applied prospectively to share-based payment transactions for which the *grant date* is on or after 1 July 2014 to avoid undue use of hindsight.

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

11 Paragraph 40 of IFRS 3 *Business Combinations* currently refers both to IAS 32 *Financial Instruments: Presentation* and 'other applicable IFRSs'. The Amendments to IFRS 3 delete the reference to 'other applicable IFRSs' and thereby require that contingent consideration – that meets the definition of a financial instrument – is classified as either a financial liability or an equity instrument in accordance with IAS 32.

12 The Amendments to IFRS 3 change the classification requirements of IAS 39 *Financial Instruments: Recognition and Measurement* so that contingent consideration is subsequently measured at fair value through profit or loss, and can no longer be measured at amortised cost as previously permitted.

13 The Amendments further clarify that the full change in the fair value of any contingent consideration that is not a financial asset or liability should be recognised in profit or loss.

14 The Amendments to IFRS 3 should be applied prospectively to business combinations for which the acquisition date is on or after 1 July 2014; this to avoid the use of hindsight.

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

15 The Amendments to IFRS 8 *Operating Segments* clarify that entities are required to describe those factors that have been considered in aggregating operating segments in accordance with paragraph 12 of IFRS 8.

16 In addition, the Amendments to IFRS 8 clarify that a reconciliation of the total of the reportable segments' assets to the entity's assets should be disclosed, if that amount is regularly provided to the chief operating decision maker in line with the requirements already existing for other mandatory reconciliations (e.g. the total of the reportable segments' liabilities).

17 The Amendments to IFRS 8 apply for annual periods beginning on or after 1 July 2014, with earlier application permitted.

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

18 Divergence in practice existed in calculating the accumulated depreciation and amortisation respectively for an item of property, plant and equipment and for an intangible asset that were measured using the revaluation method in cases where the residual value, the useful life or the depreciation method had been re-estimated before a revaluation.

19 The Amendments to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible assets* eliminate the divergence in practice by amending paragraph 35(a) of IAS 16 and paragraph 80(a) of IAS 38 to state that:

(a) the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount; and

(b) the accumulated depreciation (amortisation) is calculated as the difference between the gross carrying amount and the carrying amount after taking into account accumulated impairment losses;

20 The Amendments to IAS 16 and IAS 38 apply to all revaluations recognised in annual periods beginning on or after 1 July 2014, with earlier application permitted.

IAS 24 – Related Parties Disclosure: Key management personnel

21 The Amendments to IAS 24 *Related Parties Disclosure* provide relief so that a reporting entity is not required to disclose the components of compensation to key management personnel that is paid through another entity. Instead, amounts incurred in respect of key management personnel compensation or key management personnel services, paid or payable to another entity, shall be separately disclosed in accordance with paragraph 18A of IAS 24.

22 The Amendments to IAS 24 apply for annual periods beginning on or after 1 July 2014, with earlier application permitted.

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

23 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.

24 EFRAG started its assessment of the costs and benefits of implementing all the changes to existing standards included in the Amendments by considering whether they were likely to be any measureable costs involved for preparers – including first-time adopters – or users in applying them.

25 EFRAG's initial assessment is that there will be a year one cost for preparers in reading and understanding the Amendments to IFRS 8, to IAS 16, to IAS 24 and to IAS 38, but that cost will be insignificant. EFRAG's initial assessment is also that all requirements included in these amendments will not involve any measurable change in costs for preparers or users and that the benefits to be derived from implementing these amendments are likely to outweigh the costs involved.

26 Based on EFRAG's assessment, the application of the Amendments to IFRS 2 and to IFRS 3 will have a cost and/or benefit impact on preparers and/or users of financial information because those amendments change somehow current accounting practice; accordingly EFRAG has performed a specific assessment on the implementation of those two amendments.

27 The results of EFRAG's initial assessment can be summarised as follows:

Costs

(a) *IFRS 2 Share-based Payment – Definition of vesting condition*: Overall, EFRAG's initial assessment is that the implementation of the Amendments to IFRS 2 is likely to result in some one-off costs for preparers while we believe that these amendments will not result in increased ongoing costs both for preparers and users; and

(b) *IFRS 3 Business Combinations – Accounting for contingent consideration in a business combination*: Overall, EFRAG's initial assessment is that the Amendments to IFRS 3 are likely to result both in insignificant one-off and ongoing costs both for preparers and users.

Benefits

(a) *IFRS 2 Share-based Payment – Definition of vesting condition*: Overall, EFRAG's initial assessment is that both preparers and users are likely to benefit from the Amendments to IFRS 2, as they are likely to reduce the ongoing cost of preparing and interpreting financial information on share-based plans; and

(b) *IFRS 3 Business Combinations – Accounting for contingent consideration in a business combination:* Overall, EFRAG's initial assessment is that users and preparers are likely to benefit from the Amendments to IFRS 3, as the information resulting from them will (1) remove inconsistency in the accounting of contingent consideration and therefore reduce complexity; and (2) increase comparability between entities and therefore enhance users' analysis.

28 EFRAG published its initial assessment and supporting analysis on 31 January 2014. It invited comments on the material by 3 March 2014. In response, EFRAG received six comment letters. Five respondents agreed with EFRAG's assessment of the benefits of implementing the Amendments and the associated costs involved for users and preparers. The other one respondent 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

29 Based on its 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.

IFRS 2 Share-based Payment – Definition of vesting condition

Cost for preparers

30 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments to IFRS 2.

31 EFRAG expects that preparers will incur in one-off cost mainly from:

(a) reading and familiarising with the new requirements;

(b) review of share-based payment plans under which new grants are still being made; and

(c) applying the new requirements to share-based payment transactions for which the grant date is on or after 1 July 2014.

32 In addition, EFRAG believes that the Amendments to IFRS 2 are not likely to result in any significant increase of ongoing costs for preparers.

33 Overall, EFRAG's assessment is that the implementation of the Amendments to IFRS 2 is likely to result in some one-off costs for preparers while we believe that complying with these amendments will not result in increased ongoing costs to preparers (i.e. they are likely to be cost neutral after their initial implementation).

Costs for users

34 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments to IFRS 2.

35 Overall, EFRAG's assessment is that the implementation of the Amendments to IFRS 2 is not likely to result in one-off costs and ongoing costs to users (i.e. they are likely to be cost neutral after the initial implementation).

Benefits for preparers and users

36 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments to IFRS 2.

37 The objectives of the Amendments to IFRS 2 are to clarify the definition of a vesting condition in IFRS 2 to ensure the consistent classification of conditions attached to a share-based payment as the standard does not separately define a performance condition or a service condition, but instead describes both concepts within the definition of vesting conditions.

38 In addition, these amendments aim to clarify a number of implementation issues that have been raised by entities applying current guidance in IFRS 2. EFRAG believes that clarifying the definition of vesting conditions will reduce the operational burden for preparers in applying the requirements in IFRS 2.

39 EFRAG believes that users will benefit from these amendments as the information resulting from them will increase comparability between entities for new share-based payments granted and therefore will enhance their analysis while reducing the cost of interpreting and comparing financial data.

40 Overall, EFRAG's assessment is that both preparers and users are likely to benefit from the Amendments to IFRS 2, as they are likely to reduce the ongoing cost of both preparing and interpreting financial information on share-based plans.

IFRS 3 Business Combinations – Accounting for contingent consideration in a business combination.

Cost for preparers

41 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments to IFRS 3.

42 EFRAG believes that preparers that are already accounting for subsequent changes in the fair value of contingent consideration in profit or loss are likely to incur in insignificant costs in implementing the Amendments to IFRS 3. In addition, EFRAG believes that some preparers may incur in one-off costs in the limited circumstances if they were not accounting for changes in contingent consideration at fair value in profit or loss. Those preparers should implement processes to assess fair value at each reporting date to comply with these amendments.

43 However, EFRAG notes that prospective application of these amendments are likely to provide those entities that applied other IFRSs to measure contingent consideration with a relief that is likely to reduce significantly one-off costs of implementing the enhanced requirements.

44 Regarding ongoing costs, EFRAG notes that the Amendments to IFRS 3 clarify that all subsequent changes in fair values should be accounted in the profit or loss statement. In EFRAG's view, this will reduce complexity for preparers in accounting for contingent considerations.

45 Overall, EFRAG's assessment is that the Amendments to IFRS 3 are likely to result both in insignificant one-off and ongoing costs for preparers related to implementation of these amendments.

Costs for users

46 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments to IFRS 3.

47 In EFRAG's view, the Amendments to IFRS 3 are likely to result in one-off costs to understand the impact of the change on their analysis. In addition, EFRAG believes that the Amendments to IFRS 3 are not likely to result in increased ongoing costs for users.

48 Overall, EFRAG's assessment is that the Amendments to IFRS 3 are likely to result in insignificant costs for users.

Benefits for preparers and users

49 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments to IFRS 3.

50 The objectives of the Amendments to IFRS 3 are to clarify that both at initial recognition and at subsequent dates contingent considerations, irrespective of their nature (e.g. financial, non-financial), should be measured at fair value. In addition these amendments clarify that if contingent consideration is a financial liability, IAS 32 should be analysed in order to present is either as a financial liability or as

equity. Accordingly, these amendments result in eliminating existing conflicts between existing Standards.

51 EFRAG notes that removing current reference to other applicable IFRSs clarifies that only guidance in IFRS 3 should be applied in accounting for contingent consideration that arises in a business combination. Therefore, we believe that both users and preparers will benefit from the outcomes of these amendments as they reduce complexity in accounting for contingent consideration and they are likely to result in information that is comparable and understandable.

52 In addition, requiring that all subsequent changes in fair value of contingent considerations shall be accounted into the profit or loss statement will benefit:

(a) Preparers, as the cost to process and report into their books the effects of these transactions is likely to decrease; and

(b) Users, as the cost of assessing the effects of contingent considerations is likely to decrease because all changes into the fair value of a contingent considerations will be presented in the profit or loss statement.

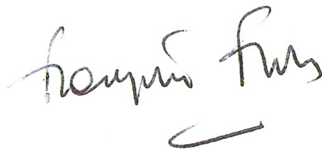
53 Finally, requiring prospective application of the requirements will provide relief to those preparers that had applied other applicable IFRSs in the accounting for contingent consideration.

54 Overall, EFRAG's assessment is that users and preparers are likely to benefit from the Amendments to IFRS 3, as the information resulting from them will (1) remove inconsistency in the accounting of contingent consideration and therefore reduce complexity; and (2) increase comparability between entities and therefore enhance users' analysis.

Conclusion

55 EFRAG's overall assessment is that the overall benefits of the Amendments are likely to outweigh costs associated with applying them.

12 March 2014



Françoise Flores
EFRAG Chairman