EFRAG
European Financial Reporting Advisory Group

DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT ON GOVERNMENT LOANS (AMENDMENTS TO IFRS 1)

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS

Comments should be sent to commentletters@efrag.org or uploaded via our website by 7 MAY 2012

EFRAG has been asked by the European Commission to provide it with advice and supporting material on *Government Loans (Amendments to IFRS 1)* ('the Amendments'). In order to do that, EFRAG has been carrying out an assessment of the Amendments against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

A summary of the Amendments is set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

EFRAG initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions on Appendix 2 and 3.

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

Accounting Standards Board (UK)

(b) Are you a:

☐ Preparer ☐ User ☒ Other (please specify)

Standard-Setter

(c) Please provide a short description of your activity:

The role of the ASB is to oversee the financial reporting requirements of UK (and Irish) entities. This is done by maintaining and improving UK Financial Reporting Standards (FRS) and influencing the development of international standards. To achieve this, the ASB collaborates with accounting standard-setters from other countries and the International Accounting Standards Board (IASB).

(d) Country where you are located:

UK

(e) Contact details including e-mail address:

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2 EFRAG's initial assessment of the Amendments is that they meet the technical criteria for endorsement. In other words, they are not contrary to the principle of true and fair view and they meet the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of the Amendments? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No

3 EFRAG is also assessing the costs that are likely to arise for preparers and for users on implementation of the Amendments in the EU, both in year one and in

subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment of costs are set out in paragraphs 5 and 8 of Appendix 3. To summarise, EFRAG's initial assessment is that overall, the Amendments are likely to reduce the one-off costs at the date of transition to IFRS for first-time adopters and do not impact the ongoing costs of applying IFRS for preparers. In addition, EFRAG's initial assessment is that the Amendments will not significantly affect the costs for users.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

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4 In addition, EFRAG is assessing the benefits that are likely to be derived from the Amendments. The results of the initial assessment of benefits are set out in paragraphs 10, 11 and 12 of Appendix 3. To summarise, EFRAG's initial assessment is that users are likely to benefit from the Amendments, as they will make it possible for more entities to adopt IFRS; while first-time adopters are likely to benefit from the Amendments, as they are likely to reduce the costs of transition to IFRS.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

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5 EFRAG's initial assessment is that the benefits to be derived from implementing the Amendments in the EU as described in paragraph 4 above are likely to outweigh the costs involved as described in paragraph 3 above.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

6 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on the Amendments.

Do you agree that there are no other factors?

☒ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

APPENDIX 1
A SUMMARY OF THE AMENDMENTS

Background

1 IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* ('IAS 20') was amended in 2008 in order to require that government loans with a below-market rate of interest should be measured at fair value on initial recognition. At the time this requirement was added, the IASB recognised that applying it retrospectively might require entities to measure the fair value of loans at an earlier date. Accordingly, the IASB decided that entities should apply this requirement in IAS 20 prospectively, with earlier application permitted.

The issue

2 In 2011 the IASB noted that the general requirement in IFRS 1 *First-time Adoption of International Financial Reporting Standards* for first-time adopters to apply IFRS retrospectively at the date of transition to IFRS could require some entities to measure government loans at fair value at a date before the date of transition to IFRS. Accordingly, the IASB decided to require that first-time adopters apply the requirements of IAS 20 prospectively to government loans existing at the date of transition to IFRS, unless the necessary information was obtained at the time they initially accounting for that loan.

What has changed?

3 The amendments add an exception to the retrospective application of IFRS to require that first-time adopters apply the requirements in IFRS 9 *Financial Instruments* (or in IAS 39 *Financial Instruments: Recognition and Measurement* if the entity has not yet adopted IFRS 9) and IAS 20 prospectively to government loans existing at the date of transition to IFRS.

4 Therefore, first-time adopters should not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant. However, entities may choose to apply the requirements of IFRS 9 (or IAS 39) and IAS 20 to government loans retrospectively if the information needed to do so had been obtained at the time of initially accounting for that loan. These amendments give first-time adopters the same relief as the one which was given to existing preparers of IFRS financial statements in 2008 when IAS 20 was amended by introducing a requirement – to be applied prospectively – that government loans with a below-market rate of interest should be measured at fair value on initial recognition. An entity should apply IFRS 9 (or IAS 39) to the measurement of such loans after the date of transition to IFRS.

When do the amendments become effective?

5 Entities are required to apply these amendments for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

APPENDIX 2

EFRAG'S TECHNICAL ASSESSMENT OF THE AMENDMENT AGAINST THE ENDORSEMENT CRITERIA

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on Government Loans (Amendments to IFRS 1) ('the Amendments').

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

Does the accounting that results from the application of the Amendments meet the technical criteria for EU endorsement?

1 EFRAG has considered whether the Amendments meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that the Amendments:

(a) are not contrary to the principle of 'true and fair view' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt the Amendments.

Relevance

2 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

3 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

4 EFRAG believes that not requiring full retrospective application of IFRS to the accounting government loans may reduce the relevance of financial information in

some circumstances (e.g. when government loans were previously measured at nil). However, full retrospective application might require an entity to apply hindsight if it has to derive a fair value that needs significant unobservable inputs, which would also reduce the relevance of financial information.

5 EFRAG believes that by permitting retrospective application of IFRS 9 (or IAS 39) when the information needed to do so was obtained at the initial accounting of the loan, the Amendments enable entities to avoid an unnecessary reduction in the relevance of financial information.

6 While EFRAG believes that the relevance of financial information might be reduced in some circumstances, the Amendments will make it possible for more entities to adopt IFRS, which will result in an overall improvement in the relevance of the information provided.

7 Accordingly, EFRAG's overall initial assessment is that the Amendments would result in the provision of relevant information; and therefore they satisfy the relevance criterion.

Reliability

8 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

9 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness

10 The Amendments extend a relief, which was already available to entities already reporting under IFRS, to first-time adopters of IFRS. In addition, the Amendments only permit retrospective application provided that the information needed to apply the general recognition and measurement requirements was obtained at the inception of the loan. By preventing the undue use of hindsight, the Amendments ensure a minimum level of reliability.

11 When government loans were previously measured at nil, it may not be possible to apply IFRS 9 (or IAS 39) to the measurement of such loans after the date of transition to IFRS. In the limited circumstances where this occurs, information may not be reliable.

12 EFRAG's overall initial assessment is that the Amendments would raise no concerns about risk of error or bias; and therefore they satisfy the reliability criterion.

Comparability

13 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

14 EFRAG has considered whether the Amendments result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

15 The Amendments provides an exception to the retrospective application of IFRS in the accounting for government loans at below-market rate of interest and thus it adversely affects the comparability of financial statements. However, EFRAG notes that by permitting retrospective application of IFRS 9 (or IAS 39) when the information needed to do so was obtained at the initial accounting of the loan, the Amendments enable entities to avoid an unnecessary reduction in the comparability of financial information.

16 The IASB decided to permit retrospective application of IAS 20 rather than require it, as the latter approach could result in an onerous search to determine whether the information had been obtained when initially accounting for loans that were received many years ago. EFRAG believes that the option to apply IAS 20 retrospectively could reduce the comparability of financial information.

17 However, EFRAG believes that the Amendments will facilitate the adoption of IFRS by more entities and, consequently, the comparability of financial statements will be enhanced.

18 On balance, EFRAG's overall initial assessment is that the Amendments satisfy the comparability criterion.

Understandability

19 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

20 Although there are a number of aspects to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

21 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will be unduly complex.

22 In EFRAG's view, the Amendments do not introduce any new complexities that may impair understandability. Therefore, EFRAG's overall initial assessment is that the Amendments satisfy the understandability criterion in all material respects.

True and Fair

23 EFRAG's initial assessment is that the information resulting from the application of the Amendments would not be contrary to the true and fair view principle.

European public good

24 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendments.

Conclusion

25 For the reasons set out above, EFRAG's initial assessment is that the Amendments satisfy the technical criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

APPENDIX 3

EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENTS

1 EFRAG has also considered whether, and if so to what extent, implementing *Government Loans (Amendments to IFRS 1)* ('the Amendments') in the EU might result in incremental costs for preparers and/or users, and whether those costs are likely to be exceeded by the benefits to be derived from it / their adoption.

Cost for preparers

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

3 EFRAG notes that the Amendments allow a first-time adopter to apply prospectively the existing guidance in relevant IFRS on recognition and measurement of a government loan at a below-market rate. Prospective application is aimed at avoiding, or at least significantly reducing, the one-off costs related to the transition to the IFRS from previous GAAP. Due to the nature of the Amendments, no impact is envisioned on entities that already apply IFRS.

4 In addition, the option for retrospective application provided may result in insignificant one-off cost for first-time adopters.

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

Costs for users

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

7 There will be some incremental costs for users if they need to compare the financial statements of entities applying the Amendments to those of entities already applying IFRS.

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

Benefits for preparers and users

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

10 EFRAG believes that the Amendments bring benefit to first-time adopters by reducing the costs of transition to IFRS while there is no impact on entities that already apply IFRS.

11 In addition, EFRAG believes that users will benefit from the Amendments as they avoid the use of hindsight in estimating fair value of government loans, thus enhancing the reliability and the quality of financial information.

12 EFRAG believes also that the Amendments will make it possible for more entities to adopt IFRS, and EFRAG's assessment is that overall users will benefit from the Amendments.

Conclusion

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