European Financial Reporting Advisory Group

The costs and benefits of implementing Government Loans (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 Government Loans (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 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

5 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?

6 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.

7 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?

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

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

9 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 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 was that the Amendments will not significantly affect the costs for users.

(b) *Benefits* – EFRAG’s initial assessment was 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.

10 EFRAG published its initial assessment and supporting analysis on 6 April 2012. It invited comments on the material by 7 May 2012. In response, EFRAG received nine comment letters. Six respondents agreed with EFRAG's assessment of the benefits of implementing the Amendments and the associated costs involved for users and preparers. The other 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

11 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

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

13 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.

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

15 Overall, EFRAG's 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

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

17 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.

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

Benefits for preparers and users

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

20 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.

21 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.

22 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

23 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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