EFRAG

European Financial Reporting Advisory Group

The costs and benefits of implementing the *Annual Improvements to IFRSs 2011-2013 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 2011-2013 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 2011-2013 Cycle* (henceforth referred to as 'the Amendments') together with the

related Basis for Conclusions. The Amendments were issued in draft form in November 2012 in the Exposure Draft ED/2012/2 *Annual Improvements to IFRSs 2011-2013 Cycle*.

6 This assessment does not cover the amendments IFRS 1 *First-Time Adoption of International Financial Reporting Standards*, 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, the amendments to IFRS 13 *Fair Value Measurement* refer 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 3 Business Combinations – Scope exceptions for joint ventures

8 The formation of a joint venture was excluded from the scope of IFRS 3 *Business Combinations* set out in paragraph 2(a) of that Standard. When IFRS 11 *Joint Arrangements* was issued, no consequential amendments were made to IFRS 3 *Business Combinations*. However, IFRS 11 had changed the definition of the term 'joint venture' from having a general meaning that included 'jointly controlled operations', 'jointly controlled assets' and 'jointly controlled entities', to meaning a specific type of joint arrangement, which does not include 'joint operations'.

9 In addition, there was uncertainty on whether the scope exclusion in paragraph 2(a) of IFRS 3 addressed (a) the accounting by the joint arrangements themselves in their financial statements only; or also (b) the accounting by the parties to the joint arrangement for their interests in the joint arrangement.

10 To address these concerns, the IASB amended paragraph 2(a) of IFRS 3 to clarify that:

(a) the formation of all types of joint arrangements are excluded from the scope of IFRS 3 by replacing 'joint venture' with 'joint arrangement'; and

(b) the only scope exclusion needed from the scope of IFRS 3 is the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.

IFRS 13 Fair Value Measurement – Scope of paragraph 52 (portfolio exception)

11 The Amendments to IFRS 13 *Fair Value Measurement* clarify that IASB did not intend to exclude from the scope of the portfolio exception any contracts that are within the scope of IAS 39 *Financial Instruments: Recognition and measurement*. Consequently, the IASB amended paragraph 52 of IFRS 13 to clarify that the portfolio exception applies to all contracts within the scope of, and accounted for in accordance with IAS 39 regardless of whether they meet the definitions of financial assets or financial liabilities as defined in IAS 32 *Financial Instruments: Presentation*.

IAS 40 Investment Property – Clarifying the interrelationship between IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property

12 The Amendments address the diversity in practice that exists regarding the scopes of IFRS 3 *Business Combinations* and IAS 40 *Investment Property*. Some believe that the standards are mutually exclusive, while others believe that an entity

acquiring an investment property with ancillary services has to determine whether it also meets the definition of a business.

13 IAS 40 is amended to clarify that judgement is needed to determine whether the acquisition of investment property is the acquisition of an asset, a group of assets or a business combination in the scope of IFRS 3 and that this judgement is not based on paragraphs 7 to 14 of IAS 40 but on the guidance in IFRS 3. However, the distinction between investment property and owner-occupied property is based on paragraphs 7 to 14 of IAS 40.

14 The amendments to IAS 40 are to be applied prospectively to avoid the use of hindsight. However, an entity may elect to apply the amendments to individual transactions that occurred prior to the beginning of the first annual period occurring on or after the effective date only if the information needed is available to the entity.

Effective date

The Amendments 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

15 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.

16 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.

17 EFRAG's initial assessment is that for the Amendments to IFRS 3 and IFRS 13 there will be a year one cost for preparers in reading and understanding the Amendments, but that cost will be insignificant. EFRAG's initial assessment is also that these amendments will not involve any significant 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.

18 Based on EFRAG's assessment, the application of the Amendments to IAS 40 will have a cost and/or benefit impact on preparers and/or users of financial information because those amendments change current accounting practice; accordingly EFRAG has performed a specific assessment on the implementation of the Amendments to IAS 40.

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

(a) Costs:

(i) Users: the Amendments to IAS 40 are likely to result in cost savings that will outweigh any incremental costs incurred by users to incorporate the new requirements in their analysis when entities elect to apply them retrospectively; and

(ii) Preparers: the Amendments to IAS 40 will not result in significantly increased costs to preparers (i.e. it is likely to be cost neutral).

(b) Benefits:

(i) Users: the information resulting from the implementation of the Amendments to IAS 40 will increase comparability between entities and therefore will enhance users' analysis; and

(ii) Preparers: the Amendments to IAS 40 will provide clarification to preparers regarding the process to select the accounting treatment that best represents the substance and the economics of the acquisition of an investment property with associated insignificant ancillary services.

20 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

21 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.

22 EFRAG's assessment is that for the Amendments to IFRS 3 and IFRS 13 there will be a year one cost for preparers in reading and understanding the Amendments, but that cost will be insignificant. EFRAG's assessment is also that these amendments will not involve any significant 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.

23 Based on EFRAG's assessment, the application of the Amendments to IAS 40 will have a cost and/or benefit impact on preparers and/or users of financial information because those amendments change current accounting practice; accordingly EFRAG has performed a specific assessment on the implementation of the Amendments to IAS 40.

IAS 40 Investment Property – Clarifying the interrelationship between IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property

Cost for preparers

24 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments to IAS 40.

25 EFRAG believes that the initial and ongoing implementation of the Amendments to IAS 40 will not result in additional costs for preparers as these amendments only clarify how current requirements in existing Standards apply.

26 Regarding the transitional provisions, EFRAG believes that some costs could arise if entities elect to apply retrospectively the Amendments to IAS 40. However, EFRAG believes that these costs will not be significant as the amendments require that entities should have already collected all relevant information needed to apply the amended requirements in IAS 40.

27 Overall, EFRAG's assessment is that the Amendments to IAS 40 will not result in significantly increased costs to preparers (i.e. it is likely to be cost neutral).

Costs for users

28 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments to IAS 40.

29 EFRAG believes that users are already familiar both with the outcomes of both IAS 40 and IFRS 3.

30 Users might incur some costs when adapting their models if entities elect to apply retrospectively these amendments to past transactions and therefore they elect to apply the acquisition accounting in IFRS 3. However, we believe that users obtain relevant information in these circumstances as all assets and liabilities acquired in a business combination are measured at fair value and therefore it is likely that they will have cost savings in performing their analysis.

31 Overall, EFRAG's assessment is that the Amendments to IAS 40 are likely to result in cost savings that will outweigh any incremental costs incurred by users to incorporate the new requirements in their analysis when entities elect to apply them retrospectively.

Benefits for preparers and users

32 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments to IAS 40.

33 In addition to the benefit highlighted in paragraph 30 above, in EFRAG's view, the Amendments to IAS 40 will reduce the divergence in practice. Therefore, users are likely to benefit, as the information resulting from the implementation of the Amendments to IAS 40 is more comparable between entities and therefore will enhance users' analysis.

34 In addition, the Amendments to IAS 40 will provide clarification to preparers and therefore they will ease the process to select the accounting treatment that best represents the substance and the economics of the acquisition of an investment property with associated insignificant ancillary services. Therefore, EFRAG believes that the Amendments to IAS 40 will result in benefits for preparers.

35 Therefore, overall, EFRAG's assessment is that both users and prepares are likely to benefit from the Amendments to IAS 40.

Conclusion

36 EFRAG's overall assessment is that the overall benefits of implementing the Amendments are likely to outweigh the costs involved.

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