EFRAG

European Financial Reporting Advisory Group

The costs and benefits of implementing IAS 1 *Presentation of Financial Statements* in the EU

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 IAS 1 *Presentation of Financial Statements (Revised).* This report sets out that information.

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 IAS 1 (Revised), 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 EFRAG has carried out seem to confirm this.) Therefore, as explained more fully in the main sections of the report, the approach EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing IAS 1 (Revised) 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 already carries out a *technical* assessment of all new and revised Standards and Interpretations issued by the IASB and IFRIC 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.

Description of IAS 1 (Revised)

4 IAS 1 sets out the general requirements for the presentation of financial statements and contains guidelines for their structure and minimum requirements for their content. IAS 1 was revised as part of the Financial Statement Presentation project, with the aim of improving the ability of investors, creditors and other financial statement users to:

(a) understand an entity's present and past financial position;

(b) understand the past operating, financing, and other activities that caused an entity's financial position to change and the components of these changes; and

(c) use that financial information (along with information from other sources) to assess the amounts, timing, and uncertainty of an entity's future cash flows.

5 IAS 1 (Revised) contains the following main amendments to existing IFRS, which are explained briefly in the paragraphs below:

(a) all owner changes in equity are to be presented separately from non-owner changes in equity in a statement of changes in equity (*Amendment A);*

(b) all non-owner changes in equity are to be presented in one or two statements of comprehensive income (*Amendment B)*;

(c) the following non mandatory titles for the primary financial statements are introduced: statement of changes in equity, statement of cash flow, statement of comprehensive income and statement of financial position (*Amendment C)*;

(d) entities are required to present of a statement of financial position as at the beginning of the corresponding period where restatements have occurred (*Amendment D)*;

(e) entities are required to disclose 'reclassification adjustments' (*Amendment E)*;

(f) entities are required to disclose income tax relating to each component of other comprehensive income (*Amendment F)*; and

(g) entities are required to present dividends and related per-share amounts on the face of the statement of changes in equity or in the notes (*Amendment G)*.

Amendments A & B - Owner changes in equity are to be presented separately from non owner changes and all non-owner changes to be presented in one or two statements of comprehensive income

6 Under the previous version of IAS 1, entities could present certain items of income and expense in the same accounting statement as the so called 'owner changes in equity' (for example increases in capital and capital distributions).

7 Furthermore, the previous version of IAS 1 required certain items of income and expense to be presented in an income statement but permitted some flexibility as to where the other items of income and expense were presented: they could be presented either (as explained above) with all changes in equity (in a statement of changes in equity) or with other non-owner changes (in a statement of recognised income and expense (so-called 'SoRIE')).

8 IAS 1 (Revised) now requires:

(a) all owner changes in equity to be presented separately from items of income and expense (so-called 'non-owner changes in equity'). It is thus not any longer possible to present non-owner changes in equity in the statement of changes in equity. The purpose of this revision is to distinguish items with different characteristics (ie owner changes in equity from non-owners changes in equity) and therefore increase the understandability of the presentation; therefore

(b) all income and expenses are to be presented either in one statement (a statement of comprehensive income) or in two statements (an income statement and a statement of comprehensive income), separately from owner changes in equity.

Amendment C - Non-mandatory changes to the titles of the primary financial statements

9 The previous version of IAS 1 used the titles “balance sheet” and “cash flow statement” to describe two of the statements within a complete set of financial statements. IAS 1 (Revised) uses “statement of financial position” and “statement of cash flows” for those statements. The new titles are however not mandatory.

Amendment D – A third statement of financial position if there have been restatements

10 IAS 1 (Revised) requires an entity to disclose comparative information in respect of the previous period, ie to disclose as a minimum two of each of the various accounting statements and related notes. IAS 1 (Revised) requires a third statement of financial position (i.e. balance sheet) to be provided in certain circumstances (so that there are two opening balance sheets as well as two closing balance sheets). This third statement is required as at the beginning of the earliest comparative period whenever the entity retrospectively applies an accounting policy or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. The purpose of this revision is to provide information that is useful in analysing an entity’s financial statements.

Amendment E - Disclosure of ‘reclassification adjustments’ (also known as ‘recycling’)

11 Under existing IFRS, some items of income and expense are recognised outside of the income statement (in the statement of recognised income and expense or the statement of changes in equity, see also above paragraphs 2-4) initially and later, on the occurrence of a specified triggering event (such as, in some cases, realisation), moved from that statement and shown in the income statement. This process is known as ‘recycling’ and the entries involved are known as ‘reclassification adjustments’. IAS 1 (Revised) requires an entity to disclose reclassification adjustments relating to each component of other comprehensive income. The purpose of this revision is to provide users with information to assess the effect of such reclassifications on profit or loss.

Amendment F – Disclosure of taxes relating to each component of other comprehensive income

12 IAS 1 (Revised) requires an entity to disclose income tax relating to each component of other comprehensive income. The previous version of IAS 1 did not include such a requirement. The purpose of this new requirement is to provide users with tax information relating to these components because the components often have tax rates different from those applied to profit or loss.

Amendment G - Presentation of dividends and related per-share amounts on the face of the statement of changes in equity or in the notes.

13 The previous version of IAS 1 permitted a choice as to where entities disclosed the amount of dividends recognised as distributions to equity holders and the related per share amount: in the income statement, in the statement of changes in equity or in the notes. IAS 1 (Revised) allows dividends recognised as distributions to owners and related per share amount to be presented only in the statement of changes in equity or in the notes. The purpose of the revision is to ensure that owner changes in equity (in this case, distributions to owners in the form of dividends) are

presented separately from non-owner changes in equity (presented in the statement of comprehensive income).

EFRAG's initial analysis of the costs and benefits of IAS 1 (Revised) and Stakeholders' views on it

14 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing IAS 1 (Revised), both in year one and in subsequent years.

15 On the basis of that initial assessment, EFRAG tentatively concluded (as explained in the basis for conclusion to the endorsement advice letter) that IAS 1 (Revised) will to a certain extent improve the quality of the financial informationprovided and, as such, that its implementation in the EU will benefit users.

16 EFRAG further tentatively concluded that IAS 1 (Revised) will:

(a) involve *preparers* incurring some year one costs—in order to read, understand and implement the new requirements—but that those costs will be insignificant;

(b) not involve *preparers* incurring significant incremental ongoing costs; and

(c) not involve *users* incurring in any incremental year one or ongoing costs.

17 Finally, EFRAG also tentatively concluded that the benefits it expected to arise from applying IAS 1 (Revised) were likely to exceed the costs involved in its implementation.

18 EFRAG published the above results of its initial assessment on 11 February 2008, together with a detailed supporting analysis. It invited comment on the material by 14 March 2008. EFRAG received 11 letters in response, all of which supported EFRAG's assessment of the costs and benefits that will arise from implementing IAS 1 (Revised).

19 In addition, EFRAG consulted its User Panel in December 2007 on the impact that IAS 1 (Revised) would have on users. Most Panel members were generally supportive of the revisions and supported EFRAG's assessment of the costs and benefits that will arise from implementing the revised standard.

EFRAG's final analysis of the costs and benefits of IAS 1 (Revised)

20 Based on its initial analysis and the stakeholders' views on that analysis, EFRAG's detailed final analysis, position and arguments are presented in the paragraphs below:

Amendment A & B - Owner changes in equity are to be presented separately from non owner changes and all non-owner changes to be presented in one or two statements of comprehensive income.

21 EFRAG has concluded for the reasons explained in its basis for conclusion to its endorsement advice letter that Amendment A will result in an improvement in the financial information provided and that Amendment B will not impair quality of the financial statements, as users of financial statements would still be able to draw exactly the same information and therefore conclusions as under old IAS 1.

22 EFRAG has also considered whether the amendments might have cost implications that might exceed the positive effects.

(a) EFRAG has considered whether these presentation requirements would be in some way more burdensome for *preparers* than the previous presentation requirements. EFRAG is of the view is that the revised requirements would involve no ongoing incremental costs compared to the existing requirements because the revised requirements do not require any new information to be provided; they merely require information already being provided to be presented in a different place. Some, relatively insignificant, costs would arise as preparers understand and implement the revised requirements for the first time, but that is all.

(b) EFRAG has also considered whether these amendments in some way increase the burden on users. EFRAG is also of the view that the required treatment imposes no significant additional burdens on users:

(i) In the case of Amendment A, there will be some insignificant year one costs involved in getting used to the new presentation, but those costs will be outweighed by the benefits derived from an improved presentation.

(ii) In the case of Amendment B, allowing preparers a choice as to whether to present one or two statements means more costs for users than if there had been no choice, but the existing standards have options in this area so EFRAG believes the incremental costs if any will be insignificant.

(c) Some EFRAG members noted that Amendment B might be understood as an 'enabling amendment'; in other words, that its implementation will make it easier for the IASB to amend the requirements again in due course to make more fundamental changes (including, for example, requiring all non-owner changes to be recognised in a single statement of comprehensive income and perhaps even to eliminate the 'net income' line from the statement). However, in EFRAG's view, the objective should be to judge each new or revised standard or interpretation on its own merits. If at some point in the future the IASB decides to amend its presentation standards fundamentally, those amendments will be evaluated against the endorsement criteria at that time.

Amendment C - Non-mandatory changes to the titles of the primary financial statements

23 EFRAG has concluded for the reasons explained in its basis for conclusion to its endorsement advice letter that Amendment C with have no effect, positive or negative, on the quality of the accounting information provided. EFRAG has also considered whether the amendment might have cost implications.

(a) EFRAG has considered whether non-mandatory changes in the names of the primary financial statements would in some way increase the burdens for *preparers*. EFRAG is of the view that the revised requirements would involve no ongoing incremental costs compared to the existing requirements—because they require no change in practice—and would involve only some insignificant implementation costs arise as preparers understand, and take decisions as to whether to implement, the new names.

(b) EFRAG has also considered whether these amendments in some way increase the burden on *users*. EFRAG is also of the view is that the required treatment imposes only insignificant additional burdens on users. Currently preparers have flexibility as to the names they call their primary financial statements, so the revised standard allowing a choice involves no incremental costs for users. There will be an implementation cost as users familiarise themselves with the new statement titles, but EFRAG's view is that this will be insignificant.

Amendment D – A third statement of financial position if there have been restatements

24 EFRAG has concluded for the reasons explained in its basis for conclusion to its endorsement advice letter that Amendment D will improve the usefulness of the information provided in financial statements. As financial statements of prior years are readily *available* for financial analysis it is normally not necessary to require the presentation an opening balance sheet for the comparative period in order to analyse the current period's financial position and performance. However, if financial statements have been affected by retrospective changes, this information is not readily available and that hampers users' ability to understand fully comparative information presented in the financial statements. The requirement to present such information in these situations therefore has positive effects for users of the financial information

25 EFRAG has also considered what the effects of the requirement to present an opening balance sheet in limited circumstances might be and whether negative effects might exceed the positive effects.

(a) Under existing standards, entities are required to present two balance sheets—one showing the position at the beginning of the current period and the other showing the position at the end of the current period. Under the revised standard, sometimes a third—showing the position at the beginning of the previous period—will also need to be provided. This will obviously involve preparers in some additional publication costs, and possibly some additional preparation costs. EFRAG considered if the preparation and presentation of such an additional balance sheet could be considered overly burdensome and costs sensitive for *preparers*. EFRAG is of the view is that:

(i) although there will be some incremental publication costs, they are not likely to be significant on an ongoing basis because entities will soon devise presentation methods that enable a third balance sheet to be provided with a minimum of disruption to the financial statements. There will be some year one implementation costs however.

(ii) there will be no incremental preparation costs, because entities will have to prepare the necessary information anyway in order to allow a correct reflection and roll forward of the financial data in the case of retrospective application of accounting policies or retrospective restatements, both as defined by IAS 8, or when reclassifications have been made.

(b) EFRAG has also considered whether the amendment in some way increases the burden on *users*. EFRAG is of the view is that there are no incremental costs for users.

Amendment E - Disclosure of 'reclassification adjustments' (ie recycling)

26 EFRAG has concluded for the reasons explained in its basis for conclusion to its endorsement advice letter that Amendment E improves the usefulness of the information provided. EFRAG believes that providing users with this information will

increase their understanding of the "performance" of the year. EFRAG has also considered whether the amendments might have cost implications that might exceed the positive effects.

(a) EFRAG considered whether the presentation of such additional information, either on the face of the statement or in the notes, would increase the burdens for *preparers*. EFRAG is of the view that the incremental ongoing cost will be insignificant because entities will have to prepare the necessary information in order to make the adjustments. The actual presentation costs will be limited. Entities will need to read, understand and implement the new requirement and that will involve some cost—so there will be year one implementation costs—but that too will not be significant.

(b) EFRAG then considered if the amendment would have any cost implications for *users*. EFRAG is of the view that the amendment will reduce the costs of users because it will make clear something that users often have to search for (and sometimes estimate) at the moment.

Amendment F – Disclosure of taxes relating to each component of other comprehensive income

27 As is explained in the basis for conclusion to EFRAG's endorsement advice letter, EFRAG has concerns about Amendment F and believes that, although it will sometimes result in the provision of useful additional information, sometimes it will not and might even reduce the usefulness of the information provided. EFRAG has also considered the cost implications of this amendment and whether they might exceed any positive effects.

(a) The amendment will require preparers to provide additional information, which increases the information basis for readers of the financial statements. The presentation of the tax relating to items included in other comprehensive income is also a requirement under the existing IAS 1, but that standard did not require separate disclosure of the taxes of the individual components of other comprehensive income. EFRAG is of the view that the revised presentation will result in some incremental ongoing costs, as well as some initial year one costs for *preparers*. The costs will not however be significant, relative to the total costs involved in preparing the financial statements.

(b) EFRAG has also considered whether the amendment in some way increases the burden on *users*. EFRAG is of the view is that there are no incremental costs for users.

Amendment G - Presentation of dividends and related per-share amounts on the face of the statement of changes in equity or in the notes.

28 EFRAG has concluded for the reasons explained in its basis for conclusion to its endorsement advice letter that Amendment G improves the useful of the financial statements. EFRAG then considered what the effects of the limitation of disclosure places in the financial statements for dividends and related per-share amounts might be and whether negative effects might exceed the positive effects.

(a) EFRAG is of the view that this amendment imposes no incremental ongoing costs on *preparers* because it does not require the provision of new information, merely the re-positioning of information already provided. There will be an insignificant year one cost as preparers understand and implement the revised requirement.

(b) EFRAG's view is also that the amendment imposes no incremental costs on *users*. Indeed, by reducing the number of places in which preparers can provide this particular piece of information from 3 to 2, the amendment makes it easier for users to find the information, thus reducing their costs slightly.

Overall conclusion

51 EFRAG's overall assessment is that:

(a) the revisions set out in IAS 1 (Revised) will result in some additional day one and ongoing additional costs for *preparers* and some additional ongoing costs for *users*, those additional costs will not be significant;

(b) although some of the revisions will result in little if any benefits, other revisions - in particular Amendments A, D, and E - will result in significant improvements in the usefulness of the information provided in many cases; and

(c) the benefits that will result from applying the amendments included in IAS 1 (Revised) will exceed the overall costs involved.

52 During its consultation process, EFRAG did not become aware of any factors other than those mentioned in this report that should be taken into account in assessing the costs and benefits of implementing IAS 1 (Revised) in the EU.

EFRAG
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