

EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF THE IMPROVEMENTS TO IFRS ISSUED IN APRIL 2009

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 *Improvements to IFRS* issued in April 2009 (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 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 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 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.

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 Interpretations Committee (IFRIC) and suggestions from staff or practitioners, and focus on areas of inconsistency in IFRSs or where clarification of wording is required.

- 5 The amendments considered in this report are the amendments made in the IASB's annual improvements standard published on 16 April 2009 entitled *Improvements to IFRSs*. The individual amendments making up the Amendments were issued in draft form in two exposure drafts that were issued in 2007 and 2008.
- 6 Set out below is a description of each of the individual amendments.

IFRS 2 Share-based Payment – Scope of IFRS 2 and revised IFRS 3

- 7 Business combinations are excluded from the scope of IFRS 2 *Share-based Payment*.
- 8 Prior to the 2008 revision of IFRS 3 *Business Combinations*, 'business combination' was defined in a way that meant that the formation of a joint venture was a type of business combination, as were combinations between entities under common control. However, as part of the 2008 revision of IFRS 3, the definition was changed and, as a result, the formation of a joint venture no longer meets the definition. Also, combinations between entities under common control may no longer meet the definition, depending on the level at which the transaction is observed. The result is that such arrangements are no longer exempt from IFRS 2.
- 9 However, the IASB had not intended to change IFRS 2's scope. This amendment amends IFRS 2 so that the formation of a joint venture and combinations between entities under common control are again exempted from the standard's scope.

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations – Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations

- 10 The IASB identified a need to clarify the disclosure requirements for non-current assets (or disposal groups) classified in accordance with IFRS 5 as held for sale or discontinued operations. That need has arisen because some apparently believe that IFRS 5 and other standards that specifically refer to non-current assets (or disposal groups) classified as held for sale or discontinued operations set out all the disclosures required in respect of those assets or operations. Others believe that the other disclosure requirements in IFRS apply unless some or all non-current assets (or disposal groups) classified as held for sale or discontinued operations are specifically excluded from the scope of those requirements.
- 11 This amendment clarifies that disclosures in standards other than IFRS 5 apply only if those standards require either:
 - (a) specific disclosures in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations, or
 - (b) disclosures about measurement of assets and liabilities within a disposal group that are not within the scope of the measurement requirement of IFRS 5 and such disclosures are not already provided elsewhere in the notes.

IFRS 8 Operating Segments – Disclosure of information about segment assets

- 12 IFRS 8 provides guidance on segment reporting, especially which items to disclose and how to disclose them. There is an apparent inconsistency in the existing standard in that paragraph 23 requires a measure of profit or loss and total assets to be disclosed for each reportable segment, whilst paragraph 25 states that information about segment assets should be disclosed only if such information is regularly provided to the chief operating decision maker. This amendment removes this inconsistency by making it clear that IFRS 8 requires measures of assets and of liabilities for each reportable segment to be disclosed only if such amounts are regularly provided to chief operating decision maker. This is also the approach adopted in US GAAP.

IAS 1 Presentation of Financial Statements – Current/non-current classification of convertible instruments

- 13 This amendment concerns the classification as either current or non-current of liabilities that can, at the option of the counterparty, be settled by the issue of the entity's equity instruments (so-called convertible instruments). The purpose of distinguishing current liabilities from non-current liabilities is to help users of the financial information to understand the liquidity and solvency position of the entity. Since settlement of a liability by issuing equity does not affect liquidity or solvency position of the entity, the IASB makes it clear in this amendment that such settlement terms are irrelevant when determining the current/non-current classification of a convertible instrument.

IAS 7 Statement of Cash Flows – Classification of expenditures on unrecognised assets

- 14 The IASB has been informed that practice differs as to the classification, in the statement of cash flows, of cash flows for expenditures incurred with the objective of generating future cash flows when those expenditures are not recognised as assets. Examples of such expenditure include research and development expenditure that has not been capitalised and uncapitalised oil and gas exploration and evaluation expenditure. Some entities classify such expenditures as cash flows from operating activities while others classify them as cash flows from investing activities.
- 15 This amendment makes it clear that only expenditures that result in an asset that is recognised in the statement of financial position shall be classified as a cash flow from investing activity.

IAS 17 Leases – Classification of leases

- 16 IAS 17 *Leases* requires that in certain situations leases of land and buildings should be bifurcated and accounted for separately. The main circumstance when this is necessary is when, if the lease of the land and the lease of the building were to be classified separately, one (usually the lease of the building) would be classified as a finance lease and the other (usually the lease of the land) as an operating lease.
- 17 The IASB is concerned that the material in IAS 17 might be read to suggest that all leases of land are operating leases. In its view, sometimes a lease of land could be a finance lease. The amendment removes the guidance in IAS 17 that land, having an indefinite economic life, is normally classified as an operating lease unless title is expected to pass to the lessee. The amendment means that the general lease

classification criteria will henceforth need to be applied to leases of land. As a result, although the indefinite economic life of most pieces of land is an important consideration for the lease classification, it is not the only consideration.

IAS 18 Revenue – Determining whether an entity is acting as a principal or as an agent

- 18 The IASB has been informed that there is some uncertainty as to how to determine whether an entity is acting as a principal or agent for the purposes of applying IAS 18 *Revenue*. The IASB has therefore amended the appendix of IAS 18 to include an example that provides guidance on the subject.

As the appendix of IAS 18 is not part of IFRS as endorsed in the EU, this amendment will have no impact on EU-endorsed IFRS. Therefore, EFRAG has not analysed it as part of its assessments of the Amendments; and all references henceforth to 'the Amendments' are references to the amendments in the standard other than this amendment.

IAS 36 Impairment of Assets – Unit of accounting for goodwill impairment test

- 19 According to paragraph 80 of IAS 36, goodwill arising from a business combination shall be allocated to a cash generating unit (CGU), or a group of cash generating units, which is/are expected to benefit from the synergies of the business combination. Paragraph 80 goes on to say that such a unit or group of units shall, inter alia, "not be larger than an operating segment determined in accordance with IFRS 8." However, paragraph 12 of IFRS 8 permits two or more operating segments to be aggregated into a single segment in certain circumstances, and the IASB has been informed that there is some uncertainty as to whether paragraph 80 of IAS 36 refers to an operating segment before or after aggregation.
- 20 The amendment clarifies that the largest cash-generating unit (CGU) or group of units to which goodwill should be allocated for the purpose of impairment under IAS 36 is an operating segment as defined by paragraph 5 of IFRS 8—that is before aggregation.

IAS 38 Intangible Assets

Additional consequential amendments arising from revised IFRS 3

- 21 When the IASB revised IFRS 3, it changed the standard so that it stated that, if an intangible asset acquired in a business combination can be acquired—in other words, if it meets the separability criterion—or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of that asset. At the same time, the IASB amended IAS 38 to reflect this decision. However, the IASB subsequently concluded that the amendments it made to IAS 38 do not fully reflect clearly enough the changes to IFRS 3.
- 22 The amendment seeks to address that concern by making it clear that, if an intangible asset acquired in a business combination is separable only together with another related item, it is accounted for separately from goodwill and is recognised together with the related item (which can be a related contract or an identifiable asset or liability).

Measuring the fair value of an intangible asset acquired in a business combination

- 23 The revised IFRS 3 requires intangible assets acquired in business combinations to be measured at their fair value at the date of the acquisition, and IAS 38 provides some guidance on how to measure such assets at fair value. The IASB has been informed that there are some concerns about that guidance. This amendment clarifies aspects of the guidance that applies to the measurement of intangible assets acquired in a business combination that are not traded in an active market.

IAS 39 Financial Instruments: Recognition and Measurement

Treating loan prepayment penalties as closely related embedded derivatives

- 24 IAS 39 requires derivatives embedded in other contracts to be distinguished between those that are closely related to the host contract and those that are not. Only embedded derivatives not closely related to the host contract need to be accounted for separately from the host contract. However, an inconsistency has been identified as to how the 'closely related' test should be applied to embedded prepayment options and related loan prepayment penalties.
- 25 The amendment clarifies that an option to repay a loan early would be considered closely related to the host contract if the terms of the option are such that, if it is exercised, the lender would be compensated for the loss of interest on the underlying loan.

Scope exemption for business combination contracts

- 26 A contract between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date is a forward contract. However, such contracts are specifically excluded from the scope of IAS 39. The IASB has been informed that there is currently diversity of practice as to which types of contract fall within the scope of that exemption.
- 27 The amendment clarifies that IAS 39 does not apply to any forward contracts between an acquirer and a selling shareholder in a business combination to buy or sell an acquiree at a future date within a time frame normally necessary to obtain any required approvals and to complete the transaction.

Cash flow hedge accounting

- 28 If a hedged forecast transaction results in the recognition of a financial asset or a financial liability, paragraph 97 of IAS 39 requires the associated gains or losses on the hedging instruments to be reclassified from equity to profit or loss as a reclassification adjustment (ie recycling) in the same period or periods during which the asset acquired or liability assumed affects profit or loss.
- 29 It has been noted that this wording might be problematical in situations when, for example, an entity applies hedge accounting to hedges of cash flows associated with a time period that is shorter than the time to maturity of the instrument. In such circumstances, paragraph 97 can be interpreted to suggest that the gains and losses on the hedging instrument should be reclassified to profit or loss over the time until maturity of the instrument rather than a shorter time period when hedged cash flows affect profit or loss. This is not the intention of IAS 39.

- 30 Thus the IASB has amended paragraphs 97 and 100 of IAS 39 to clarify that the gains or losses on the hedging instrument should be reclassified from equity to profit or loss in the period that the hedged forecast cash flows affect profit or loss.

Hedge accounting

- 31 As part of previous set of Improvements to IFRS, the IASB made amendments to IAS 39 to align its hedge accounting requirements with the requirements in IFRS 8 *Operating Segments*. In particular, it removed references in the hedge accounting requirements to segments where such references would be in conflict with IFRS 8's requirements. Since then, the IASB has identified some further references to segments in IAS 39's requirements that need to be deleted. This amendment does that.

IFRIC 9 Reassessment of Embedded Derivatives – Scope of IFRIC 9 and revised IFRS 3

- 32 When IFRIC 9 was issued in 2006, transactions in business combinations were excluded from its scope. At that time, 'business combination' was defined to include, inter alia, the formation of a joint venture and (some) common control transactions. (Thus, this exemption was similar to the IFRS 2 exemption discussed earlier.) However, when IFRS 3 was revised in 2008, the definition of a business combination was changed, and that change meant that the formation of a joint venture and common control transactions no longer meet the definition of a business combination and thus are no longer exempt from IFRIC 9.
- 33 The IASB did not intend to change the scope of IFRIC 9 in this way, and this amendment ensures that the formation of a joint venture and (some) common control transactions remain outside the scope of IFRIC 9.

IFRIC 16 Hedges of a Net Investment in a Foreign Operation – Amendment to the restriction on the entity that can hold hedging instruments

- 34 This amendment removes a restriction preventing entities from designating a financial instrument as a hedging instrument of the net investment in a foreign operation that holds the instrument. The reason for removing the restriction is that, if entities are able to designate such a financial instrument as a hedging instrument following all the hedge accounting requirements in IAS 39 *Financial Instruments: Recognition and Measurement* and IFRIC 16, there is no reason to prohibit hedge accounting for such a hedge.

EFrag's INITIAL ASSESSMENT OF THE COSTS AND BENEFITS OF THE AMENDMENTS AND STAKEHOLDERS' VIEWS ON THE ISSUES

- 35 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users, both in year one and in subsequent years, from implementing the Amendments. In summary, the results of that initial assessment were that the Amendments are likely to involve:
- (a) some preparers in some additional year one and ongoing costs. Taken individually those costs will, EFRAG believes, generally be insignificant (although for a few companies the costs could be more significant); indeed, some entities will already be applying some IFRSs in a way that is identical or very similar to that required by some or all of the individual amendments and for those entities it is likely that there will be little if any incremental cost

involved in implementing those particular amendments. As a result, EFRAG's assessment is that, when considered in aggregate, those costs will be insignificant;

- (b) users in no year one or ongoing incremental costs;
 - (c) improvements in the quality of the information provided. Taken individually, most of these improvements are likely to be relatively small; however, EFRAG's initial assessment is that taken together the amendments are likely to have a noticeable effect on the quality of the information provided.
- 36 The overall conclusion of EFRAG's initial assessment was that the benefits expected to arise from applying the Amendments are likely to exceed the costs involved in the implementation.
- 37 EFRAG published its initial assessment and supporting analysis for comment. The results of the consultation can be summarised as follows. Where specific responses to the questions posed were provided by respondents:
- (a) Those constituents that responded to the specific questions EFRAG asked about the tentative conclusions it had reached in its initial assessment agreed with those tentative conclusions.
 - (b) No respondent disagreed with the results of the initial assessment.

EFRAG'S FINAL ANALYSIS OF THE COSTS AND BENEFITS OF THE AMENDMENTS

- 38 Based on that initial analysis and stakeholders' views on that analysis, EFRAG's detailed final analysis of whether, and if so to what extent, implementing the Amendments in the EU might involve preparers and users incurring incremental costs, and whether those costs are likely to be exceeded by the benefits to be derived from implementing the Amendments is presented in the paragraphs below.
- 39 EFRAG started its assessment of the costs and benefits of implementing the Amendments by considering whether there were likely to be any measureable costs involved for preparers or users in implementing any of the amendments in the standard. EFRAG's assessment is that all but four of the amendments will clearly not involve any measurable change in costs for preparers or users. The four other amendments are discussed further below.

IFRS 8 – Disclosure of information about segment assets

Costs for preparers

- 40 EFRAG's assessment is that the amendment to IFRS 8 will require no changes to existing practice for some preparers, while for others the amendment could mean that they no longer have to disclose information that they do not use internally. The amendment will therefore not involve any additional ongoing costs for preparers and will in fact involve a decrease in ongoing costs for some preparers. That decrease in costs is however likely to be insignificant.
- 41 EFRAG's assessment is that the amendment will not result in any day one costs for preparers.

Costs for users

- 42 As already mentioned, for some entities this amendment will involve no change in practice. For some entities the effect will be that less segment information will henceforth be provided. However, as EFRAG's assessment of the amendment is that it will not result in the loss of relevant information), EFRAG believes that few users will try to estimate the information no longer provided from other sources. Based on this view, EFRAG's assessment is that there is likely to be only insignificant cost implications for users.

Benefits for preparers and users

- 43 This amendment achieves two things. First of all, it aligns the reporting of segment information with the entity's internal reporting and thus means that the segment information more effectively allows users to view the entity through the eyes of management than hitherto. This was seen as one of the key benefits of replacing IAS 14 with IFRS 8, so EFRAG's assessment is that it will involve some benefits for users. Those benefits are however likely to be insignificant.
- 44 The amendment also enables convergence between IFRS and US GAAP on this particular issue. Even though only disclosures are involved, this will still enhance the comparability of financial statements globally, which will benefit users—albeit probably only by a fairly insignificant amount.

Conclusion

- 45 EFRAG's assessment is therefore that this amendment will have only insignificant cost implications for preparers, no cost implication for users, but will also result in only insignificant benefits.

IAS 17 – Classification of leases of land and buildings

Costs for preparers

- 46 The amendment to IAS 17 will require entities that previously classified all leases of land as operating leases without carrying out a full analysis of the facts and circumstances to henceforth analyse such leases fully in order to classify them. EFRAG's assessment is therefore that the amendment will involve year one costs for preparers with lease arrangements that include land.
- (a) Some preparers may have difficulty obtaining certain information that existed at the inception of the lease, such as the fair value of the land, for leases entered into a long time ago. Those preparers may need to use the transitional provisions of the amendment to avoid incurring excessive costs to obtain that information.
- (b) Preparers that only have leases of land that are part of leases of land and buildings where the building is classified as an operating lease are more likely to have information as at the inception of the lease to assess the classification of the building.
- 47 The amendment will involve, for some entities, more work than hitherto to classify a lease of land, so it will result in some entities incurring additional year one costs. However, EFRAG's assessment is that those additional costs are likely to be insignificant.

- 48 If a preparer concludes that a land lease needs to be reclassified as a finance lease, there are likely to be some ongoing additional costs because applying finance lease treatment requires separate accounting for the leased asset and lease obligation and is therefore more costly than accounting for the same leases as operating leases. However, EFRAG's assessment is that those ongoing costs will also usually be insignificant.

Costs for users

- 49 EFRAG does not believe that the amendment will increase the costs incurred by users in analysing the financial statements as a result of its adoption.

Benefits for preparers and users

- 50 In issuing the amendment, the IASB is addressing a significant issue in certain countries in which property rights are obtained through long-term leases. Applying the general lease classification criteria to these leases results in the classification of a lease of land that reflects its economic substance. EFRAG's assessment is that the amendment will improve the quality of the financial reporting for entities that lease land on a long-term basis, albeit probably only to an insignificant degree.

Conclusion

- 51 EFRAG's assessment is therefore that this amendment will have only insignificant cost implications for preparers, no cost implications for users, but will result in only insignificant benefits.

IAS 36 Impairment of Assets – Unit of accounting for goodwill impairment test

Costs for preparers

- 52 The amendment to IAS 36 clarifies the lowest level at which goodwill impairment testing should be carried out under IAS 36. EFRAG's assessment is that this amendment could require some entities to change their existing practice and henceforth to carry out their goodwill impairment tests on smaller cash-generating units than hitherto. For those preparers there is likely to be some incremental costs arising from such a change, both when the amendment is implemented and thereafter.
- 53 EFRAG members have differing views as how significant these costs will be; with a minority believing that for some preparers the costs could be significant. However, EFRAG's assessment is that these costs will not be significant.

Costs for users

- 54 EFRAG does not believe that the amendment will create any additional costs for users analysing the financial statements.

Benefits for preparers and users

- 55 The objective of the amendment is to clarify the unit for goodwill allocation used for impairment testing and thereby eliminate the current diversity in practice in accounting for the allocation. EFRAG members have differing views as to the benefits that will arise from the way IFRS has been clarified, with a minority believing that there will be no benefits because the lower level of impairment testing

as required by the amendment will, in their view, not produce a different accounting outcome. However, EFRAG's assessment is that the amendment will eliminate diversity in existing practice and result in IAS 36 being implemented appropriately. This will benefit all stakeholders, albeit probably not significantly.

Conclusion

- 56 EFRAG's assessment is therefore that this amendment will have only insignificant cost implications for preparers and no cost implications for users; and will result in benefits for all stakeholders. EFRAG's assessment is that those benefits are likely to outweigh the increased costs.

IAS 39 – Scope exemption for business combination contracts

Costs for Preparers

- 57 The amendment to the IAS 39 exemption for business combination contracts clarifies the scope of an existing exemption in IAS 39. It will as a result require change for some preparers, but not all. However, the transitional provisions require prospective application to all unexpired contracts for annual periods beginning on or after 1 January 2010, which will minimise the year one costs for those preparers having to change. As a result, EFRAG's assessment is that the year one costs of implementing the amendment will be insignificant.
- 58 Going forward, there will be costs involved in reporting contracts that do not fall under the exemption; such contracts would need to be reported at fair value with fair value changes reported in profit or loss. However, such costs are due to the existing IFRS requirements to report all derivatives at fair value and therefore are not incremental as such.

Cost for users

- 59 We do not expect users to incur any year one or incremental ongoing costs as a result of this amendment.

Benefits for preparers and users

- 60 The amendment eliminates the uncertainty in the application of IFRS and this should be of benefit to all stakeholders, albeit probably not significantly.

Conclusion

- 61 EFRAG's assessment is therefore that this amendment will have only insignificant cost implications for preparers and no cost implication for users; and will result in benefits for all stakeholders. EFRAG's assessment is that those benefits are likely to outweigh the increased costs.

Transitional arrangements

- 62 Entities are required to apply some of the amendments retrospectively. Although in theory this could be quite an extensive exercise EFRAG believes that the accounting policies that will generally be used will mean that, across all preparers as a whole, the year one costs of doing this will not be significant.

- 63 As not all the amendments are to be applied retrospectively, there will be some comparability issues for users but EFRAG believes that those issues will not be significant.

Conclusion

- 64 Summarising the overall assessment is that:
- (a) implementing the Amendments will result in only insignificant year one and incremental ongoing costs for preparers, and will not result in any increase in costs for users; and
 - (b) the Amendments are likely to result in improvements in the quality of the information provided. Taken individually, most of these improvements are likely to be relatively small; however, EFRAG's assessment is that taken together the Amendments are likely to have a noticeable effect on the quality of the information provided.
- 65 EFRAG's overall conclusion is therefore that the benefits that will result from applying the Amendments in the EU are likely to exceed the costs of doing so.

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14 September 2009