EFRAG

European Financial Reporting Advisory Group

The costs and benefits of implementing IFRS 13 *Fair Value Measurement*

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 IFRS 13 *Fair Value Measurement* (IFRS 13).

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 IFRS 13, 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 IFRS 13 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 IFRS 13

Background

4 A number of IFRSs require or permit entities to measure certain assets, liabilities or own equity instruments at their fair value or to disclose that measure. As different IFRSs requiring or permitting the use of the fair value for measurement or disclosure purposes were developed at different points in time, guidance on fair value measurement was dispersed across various standards.

The issue

5 The guidance on how to measure fair value was inconsistent across different IFRSs, and the guidance was less detailed. These inconsistencies have led to diversity in practice and impaired comparability of information reported in financial statements. In addition, the recent financial crisis emphasised the importance of improving the guidance on and disclosures about measuring fair value.

What has changed?

6 IFRS 13 *Fair Value Measurement* sets out a single source of comprehensive guidance on *how to* measure the fair value of both financial and non-financial assets and liabilities. IFRS 13 applies when another IFRS requires or permits fair value measurement or disclosures about fair value measurements, thus it does not set out requirements on "when to" apply fair value measurement. While IFRS 13 includes descriptions of certain valuation approaches and techniques, it is not a valuation standard and does not prescribe how valuations should be performed.

7 The main changes introduced by IFRS 13 include the following:

(a) *Exit price* – IFRS 13 defines the fair value as an exit price. Previously, the fair value of liabilities was defined by reference to an exit price; however, the fair value of assets was defined based on the broader 'exchange' notion and did not specify whether the exchange was considered from an entry or an exit perspective.

(b) *Principal market as an exit market* – IFRS 13 gives priority to information derived from the market with the greatest volume and level of activity for the asset or liability being valued; therefore, fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the principal market for the asset or liability, or in its absence, in the most advantageous market.

(c) *Highest and best use for non-financial assets* – in measuring the fair value of a non-financial asset, IFRS 13 requires considering a market participant's ability to generate economic benefits by using the asset in its highest and best use by selling it to another market participant that would use the asset in its highest and best use. Highest and best use refers to the use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities with which the asset would be used. This is now a defined concept, which is applied to non-financial asset only, because financial assets do not have alternative use. A financial asset has specific contractual terms and can have a different use only if these contractual terms are changed. If the contractual terms change, that particular asset becomes a different asset.

(d) *Use of fair value of the corresponding asset as the fair value of a liability or equity instrument when a quoted price is not available* – if no quoted price is available for a liability or an equity instrument, but an identical item is held by another party as an asset, IFRS 13 requires determining the fair value of such liability or an equity instrument by reference to the quoted price for the asset. This is a new requirement.

(e) *Comprehensive disclosure requirements* – IFRS 13 introduces more comprehensive disclosures, including fair value hierarchy disclosures for non-financial items (such disclosures are already required by IFRS 7 *Financial Instruments: Disclosures* in relation to financial items), more detailed information in interim financial reports about the fair value of financial instruments measured at fair value and more extensive disclosures in situations, when unobservable inputs are used for measuring an asset or liability (so-called Level 3 inputs).

When does IFRS 13 become effective?

8 IFRS 13 specifies prospective application for annual periods beginning on or after 1 January 2013. The disclosure requirements of IFRS 13 need not be applied to comparative information provided for periods before initial application of the standard. Earlier application is permitted; however, entities shall disclose this fact.

EFRAG's initial analysis of the costs and benefits of IFRS 13

9 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing IFRS 13, both in year one and in subsequent years. The results of EFRAG's initial assessment can be summarised as follows:

(a) *Costs* – for preparers, IFRS 13 would involve some incremental costs compared to the existing requirements, but these costs are not expected to be significant. For users, IFRS 13 is likely to be neutral in terms of costs.

(b) *Benefits* – IFRS 13 will facilitate preparers in applying and users in better understanding the fair value measurements applied in financial statements and will help to improve consistency in the application of fair value measurement.

10 EFRAG published its initial assessment and supporting analysis on 18 November 2011. It invited comments on the material by 18 December 2011. In response, EFRAG received nine comment letters. Seven respondents agreed with EFRAG's assessment of the benefits of implementing IFRS 13 and the associated costs involved for users and preparers. One respondent disagreed with the assessment and one did not comment specifically on EFRAG's initial assessment of the costs and benefits of implementing IFRS 13 in the EU.

EFRAG's final analysis of the costs and benefits of the IFRS 13

11 Based on its initial analysis and stakeholders' views on that analysis, EFRAG's detailed final analysis of the costs and benefits of the IFRS 13 is presented in the paragraphs below.

Cost for preparers

12 EFRAG has carried out an assessment of the cost implications for preparers resulting from IFRS 13.

13 EFRAG notes that the only change resulting from IFRS 13, which is expected to affect the costs for preparers, is a requirement to provide more comprehensive disclosures. EFRAG also notes that information required for IFRS 13 disclosures is already collected for measuring fair values, although not all of it might be included in the financial statements at present.

14 EFRAG's assessment is that the additional time needed to prepare the specific disclosures based on the existing information, might result in some incremental costs for preparers compared to the existing requirements. If fair value measurement is required on the initial recognition only, then it will be a non-recurring cost, if fair value is a subsequent measurement requirement, then it will be a recurring cost. However, these costs are not expected to be significant.

15 Additionally, as IFRS 13 is wide-ranging and brings in several new concepts, some one-off costs would also arise as preparers need to get acquainted with the new standard before IFRS 13 first-time implementation, but these costs are not expected to be significant.

Costs for users

16 EFRAG has carried out an assessment of the cost implications for users resulting from IFRS 13.

17 As indicated above, IFRS 13 requires more comprehensive disclosures; however, similar information is already used by preparers for measuring fair value and may be provided to users outside of financial statements at present. Therefore, IFRS 13 is unlikely to increase significantly the time required for a user to perform an analysis.

18 IFRS 13 is not expected to result in any incremental costs for users to incorporate the new requirements in their analysis.

19 Overall, EFRAG's assessment is that IFRS 13 is likely to be neutral in terms of costs for users.

Benefits for preparers and users

20 EFRAG has carried out an assessment of the benefits for users and preparers resulting from IFRS 13.

21 EFRAG's assessment is that IFRS 13 will facilitate preparers in applying and users in better understanding the fair value measurements applied in financial statements and will help to improve consistency in the application of fair value measurement.

Conclusion

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

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