EFRAG

European Financial Reporting Advisory Group

The costs and benefits of implementing the *Annual Improvements to IFRSs 2009-2011 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 2009-2011 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 Invitation to Comment deals with the amendments made by the International Accounting Standards Boards within the annual improvements project which were included in the standard published on 17 May 2012 *Annual Improvements to IFRSs 2009-2011 Cycle* (henceforth referred to as 'the Amendments') together with the related Basis for Conclusions. The Amendments were issued in draft form in June 2011 in the Exposure Draft ED/2011/2 *Improvements to IFRSs*.

6 Set out below is a description of each of the Amendments made by the standard. The IASB decided that all the amendments apply for annual periods beginning on or after 1 January 2013, with earlier application permitted.

IFRS 1 First-time Adoption of International Financial Reporting Standards

7 The amendments to IFRS 1 provide guidance on two distinct issues:

(a) the repeated application of IFRS 1; and

(b) borrowing costs relating to qualifying assets for which the commencement date for capitalisation is before the date of transition to IFRSs.

8 The IASB decided to clarify that an entity that meets the criteria for applying IFRS 1 and that has applied IFRSs in a previous reporting period, may choose to apply IFRS 1 when it re-adopts IFRSs if its most recent annual financial statements do not contain an explicit and unreserved statement of compliance with IFRSs. In addition, the IASB clarified that an entity may apply IFRSs retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Estimates and Errors* as if the entity had never stopped applying IFRSs. Furthermore, the IASB decided to require certain disclosures when an entity re-adopts IFRSs.

9 Regarding borrowing costs, the IASB clarified that if an entity chooses to apply the exemption currently in IFRS 1, borrowing costs that were capitalised in accordance with its previous GAAP should be carried forward in its opening statement of financial position. In addition, the IASB clarified that an entity should account for borrowing costs that are incurred after the date of transition and that relate to qualifying assets under construction at the date of transition in accordance with IAS 23 *Borrowing Costs*, regardless of whether the entity capitalised or recognised in profit and loss borrowing costs under previous GAAP. A first-time adopter could also choose to apply the requirements of IAS 23 from a date earlier than the date of transition, in which case it should account for borrowing costs in accordance with IAS 23 on or after the earlier date selected.

IAS 1 Presentation of Financial Statements

10 IAS 1 requires presentation of comparative information in circumstances when an entity changes accounting policies, or makes retrospective restatements or reclassifications, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* with reference to the opening statement of financial position. The IASB decided to change these requirements so that related notes to the opening statement of financial position are no longer required to be presented. In addition, the IASB decided to require the presentation of a third statement of financial position only if a change in an accounting policy, a retrospective restatement or a reclassification has a material effect upon the information in the statement of financial position.

11 IAS 1 does not specifically address which comparative information should be presented when an entity provides financial statements beyond the minimum comparative information requirements on a voluntary basis. The IASB decided that an entity may present comparative information in addition to the minimum comparative financial statements required by IFRSs, as long as that information is prepared in accordance with IFRSs. This comparative information may consist of one or more statements referred to in paragraph 10 of IAS 1, but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

12 Finally, the Amendments to IAS 1 provide guidance on narrative information provided in the financial statements for the previous period which continues to be relevant in the current period. The IASB believed that users may benefit from the disclosure of the existence of an uncertainty at the end of the preceding period and from the disclosure of information about the steps that have been taken during the period to resolve the uncertainty.

IAS 16 Property, Plant and Equipment

13 The IASB decided to clarify that items such as spare parts, stand-by equipment and servicing equipment qualify as property, plant and equipment when they meet the definition of property, plant and equipment; otherwise they are classified as inventory.

IAS 32 Financial Instruments: Presentation

14 The IASB addressed a perceived inconsistency between IAS 12 *Income Taxes* and IAS 32 *Financial Instruments: Presentation* recognising income tax relating to distributions to holders of an equity instrument and income tax relating to transaction costs of an equity transaction.

15 Accordingly, the IASB decided to clarify that the income tax consequences of dividends should be recognised in profit or loss in accordance with paragraph 52B of IAS 12. Therefore, to the extent that the dividend relates to income arising from a transaction that was originally recognised in profit or loss, the income tax on the dividend should be recognised in profit or loss. Whereas if the dividend relates to income or a contribution arising from a transaction that was originally recognised in other comprehensive income or equity, respectively, the entity should apply the exception in paragraph 58(a) of IAS 12, and recognise the income tax consequences of the dividend outside of profit or loss. The amendment also clarifies that the tax effect of distributions to holders of an equity instrument other than dividends and the tax effect of transaction costs of an equity transaction are recognised in accordance with the principle in paragraph 57 of IAS 12.

16 These amendments are not intended to address the distinction between income tax consequences of dividends in accordance with paragraph 52B of IAS 12 and withholding tax for dividends in accordance with paragraph 65A of IAS 12. When an entity pays dividends to its shareholders the portion of the dividends paid or payable to taxation authorities as withholding tax is charged, in accordance with paragraph 65A, to equity as part of the dividends.

IAS 34 Interim Financial Reporting

17 The IASB decided to clarify that total assets and liabilities for a particular reportable segment are required to be disclosed only if (1) a measure of total assets or a

measure of total liabilities (or both) is regularly provided to the chief operating decision maker; and (2) there has been a material change from the amounts disclosed in the last annual financial statements for that reportable segment.

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

18 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.

19 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.

20 Overall, EFRAG's initial assessment was that 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 was also that all requirements included in the Amendments will not involve any measurable change in costs for preparers or users and that the benefits to be derived from implementing the Amendments are likely to outweigh the costs involved.

21 EFRAG published its initial assessment and supporting analysis on 25 June 2012. It invited comments on the material by 25 July 2012. In response, EFRAG received eight 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. Two other respondents 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

22 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.

23 EFRAG's assessment is that 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 all requirements included in the Amendments will not involve any measurable change in costs for preparers or users and that the benefits to be derived from implementing the Amendments are likely to outweigh the costs involved.

24 Based on EFRAG's assessment, the application of the amendments in the following two areas will have a cost and/or benefit impact on preparers and/or users of financial information because those amendments change somehow current accounting practice; accordingly EFRAG has performed a specific assessment on the implementation of those two amendments.

IFRS 1 First-time Adoption of International Financial Reporting Standards – Repeated application of IFRS 1

Cost for preparers on first-time adoption

25 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards – Repeated application of IFRS 1 ('the Amendments to IFRS 1').

26 The Amendments to IFRS 1 permit entities that re-adopt IFRSs to choose, depending on specific facts and circumstances, to apply either IFRS 1 or IAS 8 upon adoption of IFRSs. Therefore, EFRAG believes that the Amendments to IFRS 1 will reduce the costs to re-adopt IFRSs as entities can choose the least costly approach.

27 Overall, EFRAG's assessment is that the Amendments to IFRS 1 are likely to reduce the costs for preparers to re-adopt IFRSs.

Costs for users

28 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments to IFRS 1.

29 EFRAG believes that there will be some incremental costs for users if they need to compare the financial statements of entities applying the Amendments to IFRS 1 to those of entities already applying IFRS in case an entity elects to re-apply IFRS 1. However, EFRAG understands that users are already familiar with IFRS 1 and that the disclosures required upon re-adoption of IFRSs will mitigate the costs to be incurred by users.

30 Overall, EFRAG's assessment is that the Amendments to IFRS 1 will not result in significant costs to users.

Benefits for preparers and users

31 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments to IFRS 1.

32 EFRAG believes that the Amendments to IFRS 1 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.

33 In addition, EFRAG believes that users will benefit from the Amendments as they permit the retrospective application of IFRSs in circumstances, thus enhancing the reliability and the quality of financial information. In addition, the Amendments to IFRS 1 introduce new disclosure requirements that increase the understandability of the financial statements.

IFRS 1 First-time Adoption of International Financial Reporting Standards – Borrowing costs relating to qualifying assets for which the commencement date for capitalisation is before the date of transition to IFRSs

Cost for preparers on first-time adoption

34 EFRAG has carried out an assessment of the cost implications for preparers resulting from the amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards – Borrowing costs relating to qualifying assets for which the commencement date for capitalisation is before the date of transition to IFRSs ('the Amendments to IFRS 1').

35 EFRAG notes that the Amendments to IFRS 1 allow a first-time adopter to apply prospectively the existing guidance in IAS 23 on capitalisation of borrowing costs. 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 to IFRS 1, no impact is envisioned on entities that already apply IFRSs.

36 EFRAG's assessment is that the Amendments to IFRS 1 are likely to reduce the one-off costs at the date of transition to IFRSs and do not impact the ongoing costs of applying IFRSs for preparers.

Costs for users

37 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments to IFRS 1.

38 There will be some incremental costs for users if they need to compare the financial statements of first-time adopters to those of entities already applying IFRSs. However, EFRAG notes that the relief for preparers is similar to other reliefs in IFRS 1.

39 Overall, EFRAG's assessment is that the Amendments to IFRS 1 will not significantly affect the costs for users.

Benefits for preparers and users

40 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments to IFRS 1.

41 EFRAG believes that the Amendments to IFRS 1 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.

42 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

43 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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