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Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE

**Financial Reporting**

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**Endorsement of Amendment to IFRS 1 First-time adoption of  
IFRS - *Limited Exemption from Comparative IFRS 7 Disclosure for  
First-time Adopters***

**Introduction, background and conclusions**

Attachment 1: Effect study prepared by the European Financial Reporting  
Advisory Group (EFRAG)

Attachment 2: Endorsement advice prepared by EFRAG

## 1. INTRODUCTION

The European Commission has agreed with the European Parliament that Effect Studies should be prepared for new accounting standards and interpretations up for endorsement in the European Union. The Commission Services together with European Financial Reporting Advisory Group (EFRAG) prepare these studies containing description of the accounting issues involved, results from stakeholder consultations as well as an analysis of effects of using the new accounting rules in the EU.

EFRAG has prepared an Effect Study for the amendment to IFRS 1 *First-time adoption of IFRS - Limited Exemption from Comparative IFRS 7 Disclosure for First-time Adopters* (attached). As the EFRAG Effect Study refers to the Endorsement Advice, we also included it in attachments. In the light of the size and extent of the issue, the Commission Services asked EFRAG to prepare a small report.

This cover note contains introduction, comments and a conclusion by the Commission Services.

## 2. BACKGROUND ON AMENDMENTS TO IFRS 1

### *Requirements of IFRS 1 and IFRS 7*

In March 2009, the IASB amended IFRS 7 *Financial Instruments: Disclosures* to require enhanced disclosures about fair value measurements and liquidity risk. Due to the urgent need for the enhanced disclosures, the IASB had to forego a normal lead time (at least 6-18 months from issue to the effective date) and required entities to provide the enhanced disclosures in financial years starting on or after 1 January 2009. The IASB concluded that a lack of the lead time could have precluded most entities from presenting comparative information without significant effort and potential hindsight and provided relief that in the first year of application of the amendment, entities need not provide comparative information for the disclosures required by the amendment.

Subsequent to the issuance of the above amendment to IFRS 7, it was brought to the attention of the IASB that the relief regarding restatement of comparatives, as explained above, are not available for entities that apply IFRS for the first time. The IASB decided that such entities would be in the same position as existing preparers of IFRS and as such the same relief should apply and issued this Amendment.

Thus, clarification is needed.

### *How does the amendment to IFRS 1 deal with the issue?*

The proposed amendment to IFRS 1 and IFRS 7 relieves first-time adopters of IFRSs from providing the additional disclosures introduced in March 2009 by *Improving Disclosures about Financial Instruments* (Amendments to IFRS 7). It thereby ensures that first-time adopters benefit from the same transition provisions that Amendments to IFRS 7 provides to current IFRS preparers.

The additional disclosure requirements included in Amendments to IFRS 7 were part of the IASB's response to the financial crisis; they require enhanced disclosures about fair value measurements and liquidity risk. Additionally, the amendment to IFRS 1 clarifies the IASB's conclusions and intended transition for Amendments to IFRS 7.

The amendments to IFRS 1 become effective as from 1 July 2010, with earlier application permitted.

#### *EFRAG consultations*

EFRAG published its initial assessment and supporting analysis on 29 January 2010 and finalised its advice on 19 February 2010. EFRAG received in total 5 comment letters. All respondents overall agreed with EFRAG's assessment of the benefits of implementing the amendments to IFRS 1 and the associated costs involved for users and preparers and supported EFRAG's recommendation that the amendments to IFRS 1 should be adopted for use in Europe.

### **3. EFFECT ANALYSIS AND CONCLUSIONS**

#### *Main points identified in the EFRAG Effect Analysis*

##### Comparability

The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

Comparability of the information provided for comparative periods ending before 31 December 2009 may be affected if companies who adopt IFRS for the first time choose to use the option. However, this is outweighed by the fact that first-time adopters would then be equal to companies who already apply IFRS.

The other qualitative characteristics like relevance, reliability and understandability are not affected by this amendment.

<p>The Commission Services conclude that the amendment to IFRS 1 is a clarification to the amendments made to IFRS 7 in 2009 and result in providing first-time adopters with the same kind of exemptions as available for companies already using IFRS. Except for the criterion of comparability, this has no material impact on the general qualitative criteria.</p>
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### Costs for preparers and users

EFRAG's analysis concludes that the benefits of getting relief from certain disclosure requirements outweigh the incremental cost for users in year 1, where the amendment may result in a lack of comparability.

In terms of benefits this reduces cost for preparers on the transition to IFRS without adding benefit to users directly.

Based on the EFRAG analysis the Commission Services agree with the overall cost benefit impact of the amendment which will provide first time adopters with an option not present certain disclosures, a relief which is already granted in IFRS 7 for companies using IFRS.

#### **4. OVERALL COST-BENEFIT CONSIDERATIONS AND COMMISSION SERVICES CONCLUSIONS**

On the basis of EFRAG's Effect Study, the Commission Services have considered the main costs and benefits of endorsing the amendments to IFRS 1. The Services conclude that the benefits outweigh the costs introduced by the amendment.

The Commission Services believe that the amendments to IFRS 1 will have positive cost-benefits effects and that it should therefore be endorsed in the EU without delay.

## Attachment 1



Jörgen Holmquist  
Director General  
European Commission  
Directorate General for the Internal Market  
1049 Brussels

19 February 2010

Dear Mr Holmquist

### **Adoption of the Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards***

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the adoption of the Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, which was published by the IASB on 28 January 2010. It was issued as an Exposure Draft in November 2009 and EFRAG commented on that draft.

The Amendment provides optional relief to First-time Adopters of International Financial Reporting Standards from providing the additional fair value measurement and liquidity risk disclosures introduced by the Amendments to IFRS 7 *Financial Instruments: Disclosures* in March 2009. The Amendment ensures that First-time Adopters benefit from the same transition provisions that Amendments to IFRS 7 *Financial Instruments: Disclosures* provides to current preparers of IFRS.

The effective date of the Amendment is 1 July 2010, with early application permitted.

EFRAG has carried out an evaluation of the Amendment. As part of that process, EFRAG issued a draft version of this letter for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports the Amendment and has concluded that it meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards that:

- it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

- it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Amendment and, accordingly, EFRAG recommends its adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Stig Enevoldsen

**EFRAG, Chairman**

## APPENDIX

### BASIS FOR CONCLUSIONS

*This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IFRS 1 First-time Adoption of International Financial Reporting Standards (the Amendment).*

*In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as adviser to the European Commission on endorsement of the final IFRS or Interpretation on the issue.*

*In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.*

#### **Does the accounting that results from the application of the Amendment meet the criteria for EU endorsement?**

- 1 EFRAG has considered whether the Amendment meets the requirements of the European Parliament and of the Council on the application of international accounting standards, in other words that the Amendment:
  - (a) is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and in Article 2(3) of Council Directive 78/660/EEC; and
  - (b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG has also considered whether it is in the European interest to adopt the Amendment.

- 2 Having formed tentative views on these issues and prepared a draft assessment, EFRAG issued that draft assessment on 29 January 2010 and asked for comment on it by 18 February 2010. EFRAG has considered all comments received, and all were supportive of EFRAG's tentative conclusion that the Amendment meets the EU endorsement criteria and EFRAG should recommend its endorsement.

#### *Comparability*

- 3 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

- 4 The Amendment provides an optional relief to entities from comparative disclosures in IFRS 7 concerning fair value measurements and liquidity risk if those comparative periods end before 31 December 2009. If an entity makes use of the option, comparability of financial statements of such an entity will be affected.
- 5 However, by requiring entities to provide enhanced disclosures about liquidity risk and fair value measurement the IASB was responding to the urgent need of users of financial statements for such disclosures in the current economic climate.
- 6 EFRAG considers that the expedient adoption of the enhanced disclosures by entities in the current economic climate outweighs negative effects of reduction in comparability caused by the relief. Furthermore it should be noted that the loss in comparability will be temporary because the relief from comparative disclosures applies only if comparative periods end before 31 December 2009.

#### *Relevance*

- 7 According to the Framework, information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.
- 8 The Amendment does not raise any issues of relevance.

#### *Reliability*

- 9 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 10 The Amendment does not raise any issues concerning reliability.

#### *Understandability*

- 11 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.
- 12 The Amendment does not raise any issues concerning understandability.

#### *True and fair view*

- 13 For the reasons set out above, EFRAG sees no reason to conclude that the Amendment is inconsistent with the true and fair view requirement.

### *Cost and benefit*

- 14 EFRAG has considered whether the benefits of implementing the Amendment in the EU exceed the cost of doing so. EFRAG's assessment is that the benefits of implementing the Amendment outweigh the costs involved.

### *Conclusion*

- 15 After considering all the above arguments, EFRAG has concluded that, on balance, the Amendment satisfies the criteria for EU endorsement and that it is likely to be in the European interest to adopt it. Accordingly, EFRAG recommends its endorsement in Europe.



## **The costs and benefits of implementing the Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards***

### **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 amendment to IFRS 1 First-time Adoption to International Financial Reporting Standards *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 Amendment, 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 AMENDMENT**

- 4 In March 2009, the IASB amended IFRS 7 Financial Instruments: Disclosures to require enhanced disclosures about fair value measurements and liquidity risk. Due to the urgent need for the enhanced disclosures, the IASB had to forego a normal lead time (at least 6-18 months from issue to the effective date) and required entities to provide the enhanced disclosures in financial years starting on or after 1 January 2009. The IASB concluded that a lack of the lead time could have precluded most entities from presenting comparative information without significant effort and potential hindsight and provided relief that in the first year of application of the amendment, entities need not provide comparative information for the disclosures required by the amendment.
- 5 Subsequent to the issuance of the above amendment to IFRS 7, it was brought to the attention of the IASB that the relief regarding restatement of comparatives, as explained above, are not available for entities that apply IFRS for the first time. The IASB decided that such entities would be in the same position as existing preparers of IFRS and as such the same relief should apply and issued this Amendment.

#### **EFRAG'S INITIAL ASSESSMENT OF THE COSTS AND BENEFITS OF THE AMENDMENT**

- 6 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing the Amendment, both in year one and in subsequent years. The results of EFRAG's initial assessment can be summarised as follows:
  - (a) The benefit of the Amendment to preparers is that it will result in decrease of costs of transition to IFRS; and
  - (b) The Amendment is likely to involve users in additional costs in year one but not thereafter, albeit outweighed by benefits from improved disclosures about liquidity risk and fair value measurements in IFRS 7 that the IASB made effective expediently in response to users' needs in the current economic climate.
- 7 EFRAG published its initial assessment and supporting analysis on 29 January 2010 and invited comments by 18 February 2010. In response EFRAG received 7 comment letters. Three respondents agreed with EFRAG's assessment of the benefits of implementing the Amendment and the associated costs involved for users and preparers. The other four respondents did not comment specifically on EFRAG's initial assessment of the costs and benefits of implementing the Amendment in the EU, but supported EFRAG's recommendation that the Amendment be adopted for use in Europe.

#### **EFRAG'S FINAL ASSESSMENT OF THE COSTS AND BENEFITS OF THE AMENDMENT**

- 8 Based on its initial analysis and stakeholder views on that analysis, EFRAG's detailed final analysis of the costs and benefits of the Amendment is presented in the paragraphs below.

##### *Costs for preparers*

9 The Amendment will not result in any incremental costs for preparers.

*Costs for users*

10 There will be some incremental costs to users in year one as the Amendment may result in the lack of comparative information in financial statements of those entities that elect to make use of the relief.

*Benefits for preparers and users*

11 The relief brings benefits to preparers by reducing costs of transition to IFRS.

12 The Amendment does not benefit users directly. However, the relief is a means of enabling entities to adopt the enhanced disclosures as soon as possible, and this is of benefit to users in the current economic climate.

***Conclusion***

13 EFRAG's overall assessment is that:

- (a) The benefit of the Amendment to preparers is that it will result in decrease of costs of transition to IFRS; and
- (b) The Amendment is likely to involve users in additional costs in year one but not thereafter, albeit outweighed by benefits from improved disclosures about liquidity risk and fair value measurements in IFRS 7 that the IASB made effective expediently in response to users' needs in the current economic climate.

**Stig Enevoldsen**

**EFRAG, Chairman**

**19 February 2010**