



**EUROPEAN COMMISSION**

Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE

**Financial Reporting**

Brussels, 25 August 2010

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## **Endorsement of *Improvements to IFRSs***

### **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. EFFECT STUDY

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 (EU). The Commission Services together with the European Financial Reporting Advisory Group (EFRAG) prepare these studies containing description of the accounting issues involved, results from stakeholder consultations as well as analysis of effects of using the new accounting rules in the EU.

EFRAG has prepared an Effect Study for *Improvements to IFRSs* (attached). As the EFRAG Effect Study refers to the Endorsement Advice, we also included it in attachments.

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

## 2. BACKGROUND ON IMPROVEMENTS TO IFRSs

### *The IASB annual improvement process*

The IASB has adopted an annual process to deal with non-urgent but necessary amendments to IFRS (the "annual improvement process"). The issues dealt with in the annual improvement process arise from matters raised by IFRIC and suggestions from staff or practitioners, and focus on areas of inconsistency in IFRSs or where clarification of wording is required. The amendments to different standards are dealt with in a single document with the intention to streamline the standard-setting process.

### *The 2010 improvements project*

The work was initiated in 2008 and concluded in May 2010 with the publication of the improvement document – a collection of eleven amendments to seven standards (see table below). The amendments result from proposals that were contained in the exposure draft published in August 2009. It also includes an amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* applicable to entities with operations subject to rate regulation that was included in the exposure draft *Rate-regulated Activities*, published in July 2009. There is currently another project going on for the period 2009-2011 that will result in new amendments and improvements to IFRS.

The document presented by the IASB in May 2010 contains amendments to IFRS/IAS and to IFRIC. The majority of the amendments (eight out of eleven) are clarifications or corrections of existing IFRS or are amendments that are consequences from changes made to IFRS previously. The remaining amendments (two amendments to IFRS 1 and one amendment to IAS 34) involve changes to the existing requirements or additional guidance on the implementation of those requirements.

**Table 1.** *Topics addressed by the amendments*

IFRS	Subject of amendment
IFRS 1 <i>First-time Adoption of International Financial Reporting Standards</i>	Accounting policy changes in the year of adoption
	Revaluation basis as deemed cost
	Use of deemed cost for operations subject to rate regulation

IFRS 3 <i>Business Combinations</i>	Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS
	Measurement of non-controlling interests
	Un-replaced and voluntarily replaced share-based payment awards
IFRS 7 <i>Financial Instruments: Disclosures</i>	Clarification of disclosures
IAS 1 <i>Presentation of Financial Statements</i>	Clarification of statement of changes in equity
IAS 27 <i>Consolidated and Separate Financial Statements</i>	Transition requirements for amendments arising as a result of <i>IAS 27 Consolidated and Separate Financial Statements</i>
IAS 34 <i>Interim Financial Reporting</i>	Significant events and transactions
IFRIC 13 <i>Customer Loyalty Programmes</i>	Fair value of award credits

The effective date for each amendment is included within each area of affected IFRS. Most of the amendments become effective for annual periods beginning on or after 1 January 2011 with earlier application permitted. The amendments to IFRS 3 and IAS 27 become effective for annual period beginning on or after 1 July 2010.

#### *IASB and EFRAG consultation*

The IASB carried out a consultation according to its due process and received 74 comment letters to the Exposure Draft published in August 2009, which included more amendments than those included in the final document. Having considered the comments received and the recommendations of IFRIC the IASB decided to withdraw some amendments and to address some of those issues as part of separate projects.

EFRAG approach has been to carry out an initial evaluation of the Amendments against the EU endorsement criteria, to consult on the results of this initial evaluation and to finalise the assessment of the Amendments in the light of the comments received. Commentators to the EFRAG consultation were supportive of EFRAG's assessment of the proposed amendments and they agreed with the EFRAG's analysis of the costs and benefits associated with implementing the amendments.

### **3. EFFECT ANALYSIS**

EFRAG also carried out an assessment of the likely costs and benefits of implementing the amendments in the EU.

EFRAG's final assessment is that the majority of the Amendments (amendments to IFRS 3, IAS 1, IAS 27 and IFRIC 13) will not involve any measurable change in costs for preparers, whereas the remaining amendments, explained below, could have a marginal impact on year one cost for preparers.

**IFRS 1 *First-time Adoption of IFRSs –Use of deemed cost for operations subject to rate regulation.*** The amendment allows an entity with operations subject to rate regulation to use as deemed cost at the date to transition to IFRSs the carrying amount of the property, plant and equipments held for use in such operations determined under previous GAAP. At the date of transitions, the entity has to test those items for impairment. EFRAG assessment is that the amendment will subject preparers to one-time incremental cost because of the additional

impairment requirements. However, these costs are outweighed by the significant one-time cost savings that preparers have because no restatement for previous GAAP to IFRS are required. The amendment has an insignificant impact on cost/benefits for users.

**IAS 34 *Interim Financial Reporting – Significant events and transactions.*** IAS 34 does not require specific disclosures, it sets out disclosure principles to determine what information should be disclosed in an interim financial report. The IASB concluded that those principles needed to be further emphasised to ensure that appropriate disclosures were made in interim financial reports. The objective of the amendment is thus amending IAS 34 to place greater emphasis on the principles (significant events and transactions, updated information) and to include additional examples relating to more recent disclosure requirements. EFRAG's assessment is that the amendment will involve incremental year one cost for preparers because they probably have to adjust their system to collect more information for interim financial reporting purposes. The amendment will overall improve the quality of the information provided in the interim financial reports.

**IFRS 7 *Financial Instruments: Disclosures – disclosure of the financial effect of the extent to which collateral and other credit enhancements mitigate credit risk.*** The objective of the amendment to IFRS 7 is to provide clarity in the interaction between the qualitative and quantitative disclosure of the nature and extent of risks arising from financial instruments. The main change refers to the requirement to provide a description of collateral held as security and their financial effects in respect of the amount of the exposure to credit risk. EFRAG understands that banks will be the most affected entities by this amendment. However, having considered the fact that banks should already have in place risk management procedure to capture the data that would form the basis of the requested disclosure and the fact that the value of collateral is taken into account in measuring prudential capital requirements, EFRAG believes that the amendment should not increase the costs incurred by the preparers. Furthermore, the amendment brings benefits to the user because it allows a better understanding of the reporting entity's net credit risk exposure.

EFRAG's final assessment is that the Improvements to IFRSs will result in some additional cost for preparers but the benefits from the amendments will outweigh those costs. EFRAG has also concluded that

- the Amendments are consistent with the framework;
- the Amendments' implementation results in an improvement in accounting;
- the Amendments' application meets the criteria for EU endorsement.

EFRAG therefore recommends the adoption of the Amendments.

#### **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 *Improvements to IFRSs* and conclude that the benefits of the revision is likely to outweigh the costs introduced by the revision.

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

## Attachment 1

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



### **EFRAG'S EVALUATION OF THE COST AND BENEFITS OF IMPLEMENTING THE IMPROVEMENTS TO IFRS (ISSUED MAY 2010)**

#### **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 May 2010 (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 assessments of the likely costs and benefits of implementing the Amendments in the EU. The next steps have been 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.

**APPENDIX 1**  
**A SUMMARY OF THE AMENDMENTS**

- 1 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.
- 2 The amendments considered in this Invitation to Comment are the amendments to International Financial Reporting Standards (IFRSs) and the related Bases for Conclusions and guidance made in the International Accounting Standards Board's annual improvements standard published on 6 May 2010 Improvements to IFRSs (henceforth referred to as the Amendments). The Amendments were issued in draft form in one exposure draft on Improvements to IFRSs that were issued in 2009.
- 3 Set out below is a description of each of the Amendments made by the standard.

*IFRS 1 First-Time Adoption of International Financial Reporting Standard – Accounting policy changes in the year of adoption*

- 4 Paragraph 27 of IFRS 1 First-time Adoption of IFRSs states that "IAS 8 does not deal with changes in accounting policies that occur when an entity first adopts IFRSs. Therefore, IAS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first IFRS financial statements."
- 5 The IASB has been asked to clarify:
  - (a) whether a first-time adopter is exempt from all the requirements of IAS 8 for the interim and annual periods presented in its first IFRS financial statements;
  - (b) if and to the extent that IAS 8 does not apply, what, if any, requirements apply when an entity changes its accounting policies between the first interim financial statements and its first annual financial statements; and
  - (c) whether an entity is able under IFRS to change the way it is applying the exemptions and other reliefs available under IFRS 1 in its first annual IFRS financial statements, compared to how it applied them in preparing interim financial statements and, if it is able to change them, what if any requirements apply to those changes in accounting policies.
- 6 The IASB observed that IFRS 1 deals with the transition from local GAAP to IFRS and IAS 8 deals with changes in accounting policies thereafter. It also observed that an entity completes the transition from local GAAP to IFRS when it has finalised its first IFRS annual financial statements. Thus, a first-time adopter is exempt from all the requirements of IAS 8 for the interim and annual periods presented in its first IFRS financial statements. If that entity wishes to change the way it is applying the exemptions and other reliefs available under IFRS 1 in its first annual IFRS financial statements compared to how it applied them in preparing interim financial statements, it is free to do so; and such a change will be governed by the requirements of IFRS 1.
- 7 The IASB further noted that IFRS 1 requires reconciliations of profit or loss and of equity reported under previous GAAP to those under IFRSs at both the date of transition to IFRSs and the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP. If an entity presents interim

## *EFRAG's Effects Study Report on Implementing the Improvements to IFRS*

financial reports in accordance with IAS 34, its first interim financial report for part of the period covered by its first IFRS financial statements shall include those reconciliations.

- 8 The IASB concluded that, to comply with IFRS 1's requirement to explain its transition to IFRS, an entity should be required to explain any changes in its accounting policies or IFRS 1 exemptions it applied between its first IFRS interim financial report and its first IFRS annual financial statements. The IASB decided that the most useful information it could require was updated reconciliations between previous GAAP and IFRSs.
- 9 In March, the IASB clarified that changes made by an entity in its accounting policies or in its use of the exemptions contained in IFRS1 shall be explained in each such interim report in accordance with the requirements of paragraph 23 of IFRS 1.
- 10 The IASB is therefore proposing to amend IFRS 1 to clarify the position.

### *IFRS 1 First-Time Adoption of International Financial Reporting Standard – Revaluation basis as deemed cost and use of deemed cost for operations subject to rate regulation*

- 11 Some entities might have established a deemed cost in accordance with the accounting requirements they were following at the time for some or all of their assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatisation or initial public offering (IPO). Existing paragraph D8 of IFRS 1 permits a first-time adopter to use such an event-triggered revaluation basis as 'deemed cost' under IFRSs. The existing wording in IFRS 1 suggests that the exemption applies to events that occur before the date of transition to IFRS.
- 12 The IASB considered and concluded that the exemption should equally apply for similar events that occur after the date of transition to IFRSs but during the periods covered by the first-time adopter's first IFRS financial statements. That conclusion was based on the reasons that it would be unduly onerous because the first-time adopter would have to prepare two sets of measurements for its assets and liabilities – one to comply with IFRS and another to comply with local law. Accordingly, the exemption should equally apply when the event occurs during the period covered by the first IFRS financial statements.
- 13 At the date of transition to IFRS, the entity shall either establish a deemed cost by applying the criteria in paragraphs D5 to D7 or measure assets and liabilities in accordance with other IFRS. In other words prior to the event driven revaluation, comparative figures will either be measured in accordance with D5 to D7 or be measured in accordance with other IFRSs.
- 14 The board also concluded that the same relief should apply to an entity that adopted IFRSs in periods before the effective date of IFRS 1 or applied IFRS 1 in a prior period, provided that the event driven measurement date is within the period covered by its first IFRS financial statements.
- 15 The board also decided to extend the use of deemed cost exemption to entities with operations subject to rate regulation. The exemption allows an entity with operations subject to rate regulation to use the carrying amount of property, plant and equipment held (or previously held) for use in such operations determined under previous GAAP as their deemed cost at the date to transition to IFRSs. The entity shall apply the exemption on an 'item by item' basis.

## *EFrag's Effects Study Report on Implementing the Improvements to IFRS*

- 16 If an entity elects to use the deemed cost exemption, then it shall disclose that fact and the basis for determining the carrying amounts under the previous GAAP.
- 17 If the exemption is applied at the date of transition then an impairment test is carried out on this date in accordance with IAS 36 *Impairment of assets*.

### *IFRS 3 Business Combinations – Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS*

- 18 When the IASB issued IFRS 3 (revised 2008) it deleted the scope exemption in respect to contingent consideration in IFRS 7 *Financial Instruments: Disclosures*, IAS 32 *Financial Instrument: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*. The IASB did this to allow the acquirer to account for contingent consideration in accordance with the revised IFRS 3.
- 19 The deletion of the scope exemption was being by interpreted by some constituents as meaning that IAS 39 would apply to all contingent consideration, including the treatment of contingent consideration arising from a business combination whose acquisition date *preceded* the application of the revised IFRS 3 (pre-adoption contingent consideration). This treatment is inconsistent with the principle of prospective application of the revised IFRS 3.
- 20 The IASB has amended IFRS 3 to eliminate this inconsistency. The effect of the amendment is to require an entity to account for pre-adoption contingent consideration as an adjustment to the original cost of the business combination (i.e. goodwill would be adjusted), instead of as required by paragraph 58 the revised IFRS 3.

### *IFRS 3 Business Combinations – Measurement of non-controlling interests*

- 21 IFRS 3 (as revised in 2008) introduced a measurement choice for NCI and permits an entity to measure NCI at its acquisition date fair value *or* at NCI's proportionate share of the acquiree's identifiable net assets.
- 22 The revised IFRS 3 also replaced the term minority interests (MI) with the term NCI and changed the definition of NCI as follows:
  - (a) MI was defined as: that portion of the profit or loss and net assets of a subsidiary attributable to the equity interests that are not owned, directly or indirectly through subsidiaries, by the parent.
  - (b) NCI is defined as: the equity in a subsidiary not attributable, directly or indirectly, to a parent.
- 23 The issue is about measuring components of NCI in accordance with IFRS 3 (as revised in 2008) in a business combination at the acquisition date, when an entity chooses to measure NCI at the proportionate interest of the acquiree's net identifiable assets.
- 24 The IASB was informed that some constituents thought that the amended definition of NCI had widened the scope of instruments that it covers, to include for example, the equity components of convertible bonds, warrants, options over own shares and options under share-based payment plans under IFRS 2 *Share-based Payment* (not held by the parent). As a result, some were measuring those other components of NCI at nil.

- 25 In response to the concerns raised, the IASB proposed an amendment to IFRS 3 to limit the measurement choice to cover *non-controlling interests that are present ownership instruments and entitle their holders to a pro rata share of the entity's net assets in the event of liquidation*. The acquirer should measure other components of non-controlling interest at fair value or other measurement bases as required by IFRSs.

*IFRS 3 Business Combinations – Un-replaced and voluntarily replaced share-based payments awards*

- 26 The current IFRS 3 addresses the replacement in a business combination of share-payment awards of the acquiree with share-based payment awards of the acquirer in two scenarios:
- (a) When the acquirer is obliged to replace the acquiree awards;
  - (b) When the acquirer voluntarily replaces the acquiree awards and these awards would have expired as a consequence of the business combination.

In the first case, entities must allocate some or all the market-based value of the replacement awards to the consideration transferred for the business combination; the residual is recognised as a post-combination cost. Paragraphs B57-B62 provide guidance on how to allocate. In the second case, all the market-based value of the replacement awards should be recognised as a post-combination cost.

- 27 IFRS 3 does not address the following cases:
- (a) When the acquirer voluntarily replaces acquiree awards that would not have expired as a consequence of the business combination;
  - (b) When the acquirer does not replace the acquiree awards.

The amendments to the Application Guidance extend the same accounting treatment to all replacement awards, except those that the acquirer issues voluntarily to replace acquiree awards that would have expired. Paragraphs B57-B62 are unchanged.

- 28 The acquirer measures un-replaced acquiree awards at their market-based measure at acquisition date and includes them in non-controlling interest based on the ratio of the portion of vesting period elapsed to the original vesting period (or the new total vesting period, if longer).
- 29 The amendment shall be applied for annual periods beginning on or after 1 July 2010 with the option of early adoption.

*IFRS 7 Financial Instruments: Disclosures – Clarification of disclosures*

- 30 The Board amends IFRS 7 as follows:
- (a) the qualitative disclosures in paragraph 33 should support and enhance the quantitative disclosures in paragraphs 34–42;
  - (b) to clarify that the requirement in paragraph 36(a) to disclose information about the maximum exposure to credit risk applies to financial assets whose carrying amounts do not reflect the reporting entity's maximum exposure to credit risk and off balance sheet exposures;

## *EFRAG's Effects Study Report on Implementing the Improvements to IFRS*

- (c) to enhance paragraph 36(b) so that for each class of financial instruments, the financial effect of the extent to which collateral and other credit enhancements mitigate credit risk;
- (d) to remove the requirement in paragraph 37(c) to disclose for instruments past due but not impaired and that are determined individually impaired the description of collateral held as security and their fair value;
- (e) to remove the requirement in paragraph 36(d) to disclose carrying amount of financial instruments renegotiated to avoid becoming past due or impaired;
- (f) to clarify that the requirement in paragraph 38 applies only to foreclosed collateral held at the reporting date to be consistent with the objective to enable users to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.

### *IAS 1 Presentation of Financial Statements – clarification of statement of changes in equity*

- 31 The revised wording clarifies (paragraphs 106 and 107 were amended and paragraph 106A was added) that presentation of reconciliation requirements for classes of accumulated other comprehensive income (which are components of equity) is permitted in the notes. This amendment thus removes inconsistencies between the current wording of paragraph 106(d) and the example of the statement of changes in equity within the implementation guidance, *Part I: Illustrative presentation of financial statements*, accompanying IAS 1.

### *IAS 27 Consolidated and Separate Financial Statements – Transition requirements for amendments made as a result of IAS 27 (as amended in 2008) to IAS 21, IAS 28 and IAS 31*

- 32 The IAS 27 (as amended in 2008) resulted in various consequential amendments to other IFRSs.
- 33 Some of the consequential amendments include transitional guidance and specify whether the amendments should be applied prospectively or retrospectively (for example the amendment to IFRS 5 specifies that the amendment shall be applied retrospectively). However, other consequential amendments are silent on the transition issue.
- 34 The amendment clarifies that the 'consequential amendments' should be applied prospectively. This is consistent with the transition requirements in IAS 27 (as amended in 2008).

### *IAS 34 Interim Financial Reporting – Significant events and transactions*

- 35 The IASB has been considering whether some or all of the disclosures required by IFRS 7 *Financial Instruments: Disclosures* for annual financial statements should also be required in interim financial statements.
- 36 The IASB noted that, although IAS 34 does not require specific disclosures, it sets out disclosure principles to determine what information should be disclosed in an interim financial report. However, the IASB concluded that those principles needed to be further emphasised to ensure that appropriate disclosures were made in interim financial reports. This amendment is thus amending IAS 34 (paragraphs 15-19) to place greater emphasis on the principles (significant events and transactions, updated

information) and to include additional examples relating to more recent disclosure requirements, such as fair value measurement disclosures.

*IFRIC 13 Customer Loyalty Programmes – Fair value of award credit*

- 37 Paragraph AG2 of IFRIC 13 provides guidance on how this fair value can be estimated. However, it has been brought to the IASB's attention that, because paragraph AG2 uses the term "fair value" to refer to both the value of the award credits and the value of the awards for which the credits could be redeemed, the resulting guidance could be misinterpreted. The IASB therefore amends paragraph AG2 (and Example 1 in the illustrative examples) to clarify that, when the fair value of award credits is estimated by reference to the value of the awards for which they could be redeemed, the value of those awards shall be adjusted to reflect expected forfeitures as well as discounts or incentives.

## **APPENDIX 2**

### **EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENTS**

#### **General comments**

- 1 EFRAG has also considered whether, and if so to what extent, implementing the Amendments in the EU might involve preparers or users incurring incremental costs, and whether those costs are likely to be exceeded by the benefits to be derived from implementing the Amendments in the EU.
- 2 EFRAG started its assessment of the costs and benefits of implementing the Amendments by considering whether they were likely to be any measureable costs involved for preparers or users in implementing any of the Amendments the standard. EFRAG's assessment is that there will be a year one cost for preparers in reading and understanding the Amendments made, but that cost will be insignificant. EFRAG's assessment is also that the Amendments will not involve any measurable change in costs for preparers or users except in the areas discussed below.
- 3 Based on EFRAG's assessment, the application of the following three amendments will have a cost and/or benefit impact on preparers and/or users.

#### **IFRS1 *First-time Adoption of IFRSs - Revaluation basis as deemed cost***

##### *Costs for preparers*

- 4 EFRAG's assessment is that the proposed amendment will result in a significant one-time cost saving because the entity can elect to apply the event driven fair values as deemed cost at any date in the first IFRS financial statements.

##### *Costs for users*

- 5 EFRAG's assessment is that there will be no cost or benefit impact on users.

##### *Benefits for preparers and users*

- 6 The relief brings benefits to preparers by reducing costs of transition to IFRS.
- 7 The amendment does not benefit users directly. However the relief is a means of enabling entities to adopt IFRS without incurring significant incremental costs which leads to greater benefits over-time

#### **IFRS1 *First-time Adoption of IFRSs - Use of deemed cost for operations subject to rate regulation***

##### *Costs for preparers*

- 8 EFRAG believes that an entity applying the exemption to use the carrying amount of property, plant and equipment held (or previously held) determined under previous GAAP as their deemed cost at the date to transition to IFRSs will result in a significant one-time cost saving because no restatement from previous GAAP to IFRS would be required. This means an analysis would not have to be carried out to ensure all costs capitalised complies with existing IFRS.

## *EFRAG's Effects Study Report on Implementing the Improvements to IFRS*

- 9 However as at the date of transition to IFRS the entity will have to carry out the necessary calculations for impairment testing. This will subject preparers to one-time incremental costs but no on-going costs.
- 10 EFRAG's assessment is that the proposed amendment will result in a significant one-time reduction in costs however preparers will incur one-time additional costs because of the additional impairment requirements at the date of transition to IFRS. It is believed that the reduction in costs will outweigh the incremental costs.

### *Costs for users*

- 11 EFRAG's assessment is that there will be insignificant incremental costs to users in year one and on-going insignificant costs because of the lack of comparable information in financial statements of those entities that elect to make use of the relief.

### *Benefits for preparers and users*

- 12 The relief brings benefits to preparers by reducing costs of transition to IFRS.
- 13 The amendment does not benefit users directly. However the relief is a means of enabling entities to adopt IFRS without incurring significant incremental costs which leads to greater benefits over-time.

## **IAS 34 *Interim Financial Reporting – Significant events and transactions***

### *Costs for preparers*

- 14 EFRAG's assessment is that the amendments to IAS 34 will involve incremental year one costs for preparers. Most of that cost will arise as preparers will probably have to adjust their systems to collect more information for interim financial reporting purposes. There will probably also be some ongoing costs, but EFRAG's assessment is that those ongoing costs will usually be insignificant.

### *Costs for users*

- 15 EFRAG does not believe that the amendments will increase the costs incurred by users in analysing the financial statements as a result of its adoption. However one of the costs that would probably need to be taken into account is that requiring enhanced disclosures in the field of fair value measurements could delay the publication of interim reports.

### *Benefits for preparers and users*

- 16 EFRAG's assessment is that the amendments will overall improve the quality of the information provided in the interim financial reports.

## **IFRS 7 *Financial Instruments: Disclosures – disclosure of the financial effect of the extent to which collateral and other credit enhancements mitigate credit risk***

- 17 EFRAG has considered the cost and benefit impact of the amendment on banks because it thinks that these entities will be the most affected. EFRAG understands that banks should already have in place the risk management practices and procedures to capture the data that would form the basis of disclosure of the financial effect of under- or over-collateralisation. Hence, EFRAG does not consider that there is not a need to introduce new systems or develop new models.

- 18 Banks currently are in compliance with the requirements of Basel II, which require banks to track the data on collateral for their loans in order to benefit from lower solvency capital absorption in the presence of collateral. The value of the collateral is taken into account in the quantification of risk-weighted assets for credit risk for the purposes of quantifying the capital requirements. There are two techniques adopted for considering the value of the collateral in the quantification of risk-weighted assets: the standardised and the internal ratings-based approach. The standardised approach usually prevails amongst smaller banks and is based on standardised inputs, whereas the internal rating based approach that usually prevails amongst larger banks, bases the calculation on more sophisticated statistical modelling. This, in our view, is evidence that banks have one possible way to quantifying the financial effect of collateralisation without incurring significant costs.

*Costs for preparers*

- 19 EFRAG's assessment is that the amendment to IFRS 7 will not subject costs to preparers.

*Costs for users*

- 20 EFRAG does not believe that the amendment will increase the costs incurred by users.

*Benefits for preparers and users*

- 21 The Amendment brings benefits to users because it allows users to understand the effects that collateralisation has on the reporting entity's exposure to maximum credit risk for all financial instruments. Overall, the Amendment allows for a better understanding of the reporting entity's net credit risk exposure.

**Conclusion**

- 22 EFRAG's assessment is that the benefits from these three amendments are likely to outweigh the costs involved.

## **Attachment 2**

### Endorsement advice prepared by EFRAG



Jonathan Faull  
Director General  
European Commission  
Directorate General for the Internal Market  
1049 Brussels

23 July 2010

Dear Mr. Faull

#### **Adoption of the Improvements to IFRS (Issued in May 2010)**

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 *Improvements to IFRS* issued in May 2010 (the Amendments).

The IASB has adopted an annual process to deal with non-urgent albeit necessary amendments to IFRS (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 IASB staff or practitioners, and focus on areas of inconsistency in IFRSs or where clarification of wording is required. There are 11 individual amendments to 7 standards in the *IFRS Annual Improvements* publication issued in May 2010, covering a variety of subjects. The effective date for each amendment is included within each area of affected IFRS.

EFRAG has carried out an evaluation of the Amendments. As part of that process, EFRAG issued an initial evaluation of the Amendments against the EU endorsement criteria 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 Amendments and has concluded that they meet the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, in that:

- they are 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
- they meet 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's endorsement advice on Improvements to IFRS (Issued April 2009)*

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Amendments and, accordingly, EFRAG recommends their adoption. EFRAG's reasoning is explained in the attached 'Appendix 1 –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

Francoise Flores  
**EFRAG, Chairman**

## **APPENDIX 1 EFRAG'S TECHNICAL ASSESSMENT OF THE AMENDMENTS AGAINST THE ENDORSEMENT CRITERIA**

### **Basis for Conclusions**

*This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendments.*

*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 advisor 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.*

### **Introduction**

- 1 When evaluating the merits of the Amendments, EFRAG considered the following key questions:
  - (a) Are the requirements of the Amendments consistent with the IASB's Framework for the Preparation and Presentation of Financial Statements ("the Framework")?
  - (b) Would the Amendments' implementation result in an improvement in accounting?
  - (c) EFRAG has considered whether the Amendments meets the requirements of the European Parliament and of the Council on the application of International accounting standards, in other words that the Amendments:
    - (i) are 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
    - (ii) meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
- 2 EFRAG has also considered whether it is in the European interest to adopt the Amendments.

### **Are the requirements of the Amendments consistent with the IASB's Framework?**

- 3 EFRAG considered whether the requirements in the Amendments are consistent with the IASB's Framework. When EFRAG considered whether existing IFRSs should be endorsed, it considered whether their accounting treatments were consistent with the Framework. As the Amendments involve providing clarification and additional guidance on some accounting aspects of those existing IFRSs—and as a result do not introduce fundamental changes to existing IFRS literature—EFRAG concluded that the Amendments are consistent with the provisions in the Framework.

### **Would the Amendments' implementation result in an improvement in accounting?**

- 4 EFRAG notes that, of the eleven Amendments in the standard, the eight Amendments listed below are clarifications or corrections of existing IFRS or are Amendments that are consequences from changes made to IFRSs previously:

- IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Accounting policy changes in the year of adoption;
- IFRS 3 *Business Combinations* – Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS;
- IFRS 3 *Business Combinations* – Measuring non-controlling interests;
- IFRS 3 *Business Combinations* – Un-replaced and voluntarily replaced share-based payment awards;
- IFRS 7 *Financial Instruments: Disclosures* – Clarification of disclosures;
- IAS 1 *Presentation of Financial Statements* – Clarification of statement of changes in equity;
- IAS 27 *Consolidated and Separate Financial Statements* – Transition requirements for consequential amendments of IAS 27 to IAS 21, IAS 28 and IAS 31;
- IFRIC 13 *Customer Loyalty Programmes* – Fair value of award credits.

- 5 In EFRAG's view, the above Amendments are straightforward and not controversial; by clarifying or correcting existing IFRS in some – albeit small way – they make standards easier to implement consistently, without raising any new concerns. Those Amendments are not discussed specifically in this appendix.

- 6 The following amendments (two amendments to IFRS 1 and one amendment to IAS 34) involve changes to the existing requirements or additional guidance on the implementation of those requirements:

- IFRS 1 *First-time Adoption of IFRSs* – Revaluation basis as deemed cost and Use of deemed cost for operations subject to rate regulation; and
- IAS 34 *Interim Financial Reporting* – Significant events and transactions.

- 7 We consider the amendment to IAS 34 to be straightforward and not controversial. Therefore, we do not discuss that amendment specifically in this appendix.

*IFRS 1 First-time Adoption of IFRSs — Revaluation basis as deemed cost and Use of deemed cost for operations subject to rate regulation*

- 8 The amendment to IFRS 1 – *Revaluation basis as deemed cost* does not significantly change paragraph D8, but rather increases its scope. Hence it is unlikely that it will have a significant impact on understandability, relevance, reliability and comparability of financial statements. EFRAG has therefore not commented specifically on this amendment as the exemption already existing IFRS 1 is not altered by this amendment.
- 9 EFRAG has commented on the amendment to IFRS 1 – *Use of deemed cost for operations subject to rate regulation* here below because we believe the amendment has an impact on comparability, relevance, reliability and understandability.

Comparability

- 10 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 dissimilar items and events should be accounted for differently.
- 11 As with any introduction of a deemed cost measurement base, comparability is impaired between first-time adopters and entities that already apply existing IFRS. This is because rate regulated entities can apply the exemption to use deemed cost which may not include items that would be allowed to be capitalised under existing IFRS.
- 12 Having said that, disclosing the basis of calculations under previous GAAP will assist users to reconcile the differences between that GAAP and IFRS which will reduce to some extent the incomparability.
- 13 The amendment will allow for easier adoption of IFRS and accordingly more rate regulated entities will apply IFRS so that over-time financial statements become more comparable.
- 14 There is a cost-benefit trade off in terms of comparability; however, EFRAG thinks the benefits of applying the amendment will exceed the costs of reduced comparability.
- 15 As a result, EFRAG's assessment is that the amendment meets the comparability criterion.

Relevance

- 16 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.
- 17 EFRAG's assessment about the amendments' relevance is very similar to its assessment of comparability; there might be a short-term deterioration in relevance. However there will be an overall improvement in the relevance of the information provided. For that reason, EFRAG's overall assessment is that the amendment meets the relevance criterion.

Reliability

- 18 EFRAG also considered the reliability of the information that will be provided by applying the Amendment. 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.

- 19 The amendment allows an entity to use previous GAAP carrying amounts in its opening IFRS balance sheet. As this does not require any new estimates to be made, EFRAG believes that this does not give rise to reliability concerns.

#### Understandability

- 20 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. Although there are a number of aspects to the notion of 'understandability', EFRAG believes that most aspects are covered by the discussion above about relevance, reliability and comparability (because, for example, information that represents something as similar when it is in fact dissimilar is not comparable, and that lack of comparability will mean it is also not understandable). As a result, EFRAG believes that the main additional issue it needs to consider in assessing whether the information resulting from the application of the amendment is understandable is whether that information will be unduly complex.
- 21 EFRAG's view is that the amendment does not introduce new complexities into the financial statements.

#### True and fair view

- 22 For the reasons set out above, EFRAG does not believe that the amendment is inconsistent with the true and fair view requirement.

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

- 23 As already mentioned, EFRAG has previously concluded that the various IFRSs affected by the Amendments meet the endorsement criteria. Furthermore, as explained above, EFRAG believes that the Amendments are consistent with the Framework, and its assessment is that the Amendments are likely either to improve the financial information provided or have no effect on that information. In particular, EFRAG has concluded that the Amendments meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
- 24 EFRAG also concluded that there was no reason to believe that the information resulting from the application of the Amendments would be contrary to the true and fair view principle or that implementation of the Amendments in the EU would be contrary to the European interest.

#### **Conclusion**

- 25 EFRAG has concluded that the Amendments satisfy the criteria for endorsement in the EU and that it should recommend that the Amendments be endorsed for use in the EU.