EFRAG

European Financial Reporting Advisory Group

# The costs and benefits of implementing the amendments to IFRS 7 *Financial Instruments: Disclosures –Transfers of Financial Assets*

## 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 amendments to IFRS 7 *Financial Instruments: Disclosures –Transfers of Financial Assets* (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 this report, the approach EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the amendments in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

## EFRAG's endorsement advice

3 EFRAG also carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB and IFRIC against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

## A summary of the Amendments

*Background*

4 In the midst of the financial crisis users expressed concerns regarding the quality of disclosures about financial assets that had been transferred to third parties but:

(a) remained on the entity's balance sheet because the derecognition rules of IAS 39 *Financial Instruments: Recognition and Measurement* did not allow their derecognition; or

(b) the entity derecognised the financial assets but retained some form of continued exposure that was no longer captured by the balance sheet after derecognising these assets.

5 IFRS 7 already contained certain disclosure requirements in paragraph 13 relating to these instances. The Amendments aim to improve these disclosures.

6 The Amendments aim to help users of financial statements better evaluate the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position. Their objective is to promote transparency in the reporting of transfer transactions, particularly those that involve securitisation of financial assets.

## What has changed?

*Transferred financial assets that are not derecognised in their entirety*

7 An entity may transfer an asset to a third party but retain the risks and rewards of the transferred asset. While the asset is not derecognised, an associated liability is recognised. An exchange transaction therefore occurs although it is not reflected as such in the financial statements. The Amendments require an entity to provide:

(a) a qualitative description of the nature of the relationship between transferred assets and associated liabilities; and

(b) a schedule that sets out the fair value of the transferred financial assets, the associated liabilities and the net position when the counterparty to the associated liabilities has recourse only to the transferred assets.

8 These disclosures aim to help users of financial statement to understand the relationship between transferred financial assets and the associated liabilities, an entity's cash flow needs as well as the cash flows available to an entity from its own assets.

*Transferred assets that are derecognised*

9 It may be that an entity meets the derecognition requirements of IAS 39 and derecognises a financial asset, but maintains some form of continued exposure to

the risks and rewards related to that derecognised financial asset based on its continued involvement in such assets.

10 The Amendments require an entity to provide information about the remaining risk exposure of the entity, and in particular:

(a) Information about the timing of the return and cash flows that would or may be required to repurchase the derecognised financial asset in the future;

(b) The gain and loss, and timing thereof, recognised on derecognition of these assets; and

(c) Where an entity's derecognition activities do not occur evenly throughout the reporting period, information about the distribution of such activities.

**When do the Amendments become effective?**

11 The Amendments are effective for annual periods beginning on or after 1 July 2011. Earlier application is permitted. If an entity applies the amendments from an earlier date, it shall disclose that fact. An entity need not provide the disclosures required by these amendments for any period presented that begins before the date of initial application of the amendments.

**EFRAG's initial analysis of the costs and benefits of the amendments**

12 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. The results of EFRAG's initial assessment can be summarised as follows. The implementation in the EU of the Amendments is likely to:

(a) result in a significant improvement in the quality of the information provided about transferred financial assets and the risk related to such transactions that will benefit preparers and users alike;

(b) involve an insignificant increase in preparation costs for preparers; and

(c) reduce users' costs of analysis.

13 EFRAG published its initial assessment and supporting analysis on 9 December 2010. It invited comments on the material by 21 January 2010. In response, EFRAG received seven comment letters. Five respondents agreed with EFRAG's assessment of the benefits of implementing the Amendments and the associated costs involved for users and preparers. The 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**

14 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.

*Costs for preparers*

15 The Amendments will most likely require initial implementation and ongoing maintenance costs for preparers. However, where this type of information is already available within the internal reporting and/or risk management processes of an entity, albeit in a different format, it is unlikely that the costs will be significant. Such entities are likely to incur some incremental implementation costs while little ongoing maintenance cost is expected as the information is already gathered elsewhere within the activities. The incremental costs are likely to be insignificant.

16 Those entities that do not capture this type of information currently within any of their activities would incur incremental implementation costs and ongoing maintenance costs. While the costs may be significant in some instances, EFRAG expects these instances to be limited to those entities that enter into a large number of transfer transactions captured by the Amendments. It is likely that most of these entities would be financial institutions that would benefit from the risk management practices involved in recording these risks.

17 EFRAG's assessment is that the Amendments will not result in a significant increase in costs for preparers.

*Costs for users*

18 Users are expected to incur incremental costs to incorporate the additional information resulting from the Amendments into their analysis. These costs are likely to be insignificant. However, it is likely that users will save costs that they currently incur to obtain similar information from other sources than the financial statements.

19 EFRAG's assessment is that the Amendments will result in cost savings that will outweigh any incremental costs incurred by users to incorporate the information in their analysis.

*Benefits for preparers and users*

20 EFRAG's assessment is that the Amendments will result in a benefit for those preparers who do not currently produce this information within their internal reporting and/or risk management processes. In EFRAG's view, the disclosures provide important information regarding risk that all entities should consider in managing their activities. Those entities that already produce this information are unlikely to benefit from the Amendments, except to the extent that they do not have to provide this information through other means of communication with users.

21 In contrast, users are likely to benefit from the increased disclosures and the transparency that they achieve. It is likely that users will benefit from directly available information.

22 In addition, it is likely that users will be in a better position to forecast future cash flows related to transferred financial assets, while they will also be able to

understand better the risk exposures of an entity. Indeed, the disclosures address a key concern noted in the financial crisis.

*Conclusion*

23 EFRAG's assessment is that:

(a) the Amendments are likely to result in a significant improvement in the quality of the information provided about transferred financial assets and the risk related to such transactions that will benefit preparers and users alike;

(b) implementing the Amendments is likely to involve an insignificant increase in preparation costs for preparers; and

(c) the Amendments are likely to reduce users' costs of analysis.

16 March 2011

**Françoise Flores**
**EFRAG, Chairman**