EFRAG
European Financial Reporting Advisory Group

DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT ON AMENDMENTS TO IFRS 7 Financial Instruments: Disclosures – Transfers of Financial Assets

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS

Comments should be sent to commentletters@efrag.org or uploaded via our website by 21 January 2011

EFRAG has been asked by the European Commission to provide it with advice and supporting material on the amendments to IFRS 7 *Financial Instruments: Disclosures – Transfers of Financial Assets* (the Amendments). In order to do that, EFRAG has been carrying out a technical assessment of the amendment against the criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the EU.

A summary of the Amendments are set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

EFRAG initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions on Appendix 2 and 3.

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

German Accounting Standards Board (GASB)

(b) Are you/Is your organisation or company a:

☐ Preparer ☐ User ☒ Other (please specify)

National standard-setter

(c) Please provide a short description of your activity/the general activity of your organisation or company:

(d) Country where you/your organisation or company is located:

Germany

(e) Contact details including e-mail address:

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2 EFRAG's initial assessment of the amendment is that it meets the technical criteria for endorsement. In other words, it is not contrary to the true and fair principle and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of the amendment? If there are, what are those issues and why do you believe they are relevant to the evaluation?

There are no other issues.

3 EFRAG is also assessing the costs that will arise for preparers and for users on implementation of the amendment in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment are set out in paragraphs 2-6 of Appendix 3. To summarise, EFRAG's initial assessment is that the Amendments are likely to involve incremental year one and ongoing costs for preparers. It is unlikely that these costs will be significant.

Do you agree with this assessment?

☐ Yes ☐ No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

As a national standard-setter, we are not in a position to answer this question.

4 As explained in paragraphs 7-9 of Appendix 3, EFRAG believes that the Amendments are likely to result in improvements in the quality of the information provided.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

5 EFRAG has tentatively concluded that the benefits to be derived from implementing the Amendments in the EU as described in paragraph 4 above are likely to exceed the costs involved as described in paragraph 3 above.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

6 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on the amendment.

Do you agree that there are no other factors?

☒ Yes ☐ No

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

APPENDIX 1
A SUMMARY OF THE AMENDMENT

Background

1 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.

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

3 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

4 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.

5 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

6 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.

7 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?

8 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.

APPENDIX 2

EFRAG'S TECHNICAL ASSESSMENT OF THE AMENDMENT AGAINST THE ENDORSEMENT CRITERIA

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 Amendments meet the criteria for EU endorsement?

1 EFRAG has considered whether the Amendments meet the requirements of the European Parliament and of the Council on the application of international accounting standards, in other words that the Amendments:

(a) meet 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

(b) 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 also considered whether it would be in the European interest to adopt the Amendments.

Relevance

2 According to the Framework, information is relevant 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.

3 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

4 The Amendments focus on information about the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position. This information provides an insight into an entity's cash flow needs and the cash flows available to an entity from its own assets, and how they may change in the future. EFRAG therefore believes that this information is relevant.

Reliability

5 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.

1 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness. In EFRAG's view, the Amendments do not raise any significant issues concerning freedom from material error and bias.

6 EFRAG notes that the Amendments require information that is closely related to an entity's internal reporting and/or risk management processes. In managing its risk-exposures, an entity would most likely already monitor the information required by the Amendments. Furthermore, the disclosure requirements are of a similar nature to those already required by IFRS 7 and IAS 39. The Amendments therefore do not create any new reliability concerns in EFRAG's view.

Comparability

7 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.

8 EFRAG has considered whether the Amendments results in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

9 EFRAG believes that the Amendment results in similar transactions being disclosed in a comparable manner.

Understandability

10 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.

11 EFRAG believes that most aspects to the notion of 'understandability' are covered by the discussion above about relevance, reliability and comparability. 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, and vice versa.

12 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 Amendments is understandable, is whether that information will be unduly complex. In EFRAG's view, the Amendments do not introduce any new complexities that may impair understandability. EFRAG believes that the amended disclosure

requirements provides more clarity than those currently in IFRS 7 and therefore improves understandability.

True and Fair

13 EFRAG has also concluded that there is no reason to believe that the information resulting from the application of the Amendments would be contrary to the true and fair view principle.

European Interest

14 EFRAG has considered whether the benefits of implementing the Amendments in the EU exceed the costs of doing so. Its initial assessment (as explained more fully in Appendix 3) is that, although implementation of the Amendments would involve some costs, they are likely to be outweighed by the benefits.

Conclusion

15 EFRAG's overall conclusion is that the Amendments satisfy the criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

APPENDIX 3

EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENT

1 EFRAG has also considered whether, and if so to what extent, implementing the Amendments in the EU might involve preparers and/or users incurring incremental costs, and whether those costs are likely to be exceeded by the benefits to be derived from their adoption.

Costs for preparers

2 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.

3 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.

4 Overall, EFRAG's initial assessment is that the Amendments will not result in a significant increase in costs for preparers.

Costs for users

5 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.

6 Overall, EFRAG's initial 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

7 EFRAG's initial 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.

8 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.

9 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

10 EFRAG's overall 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.