KPMG IFRG Limited
1-2 Dorset Rise
London EC4Y 8EN
United Kingdom

Tel +44 (0)20 7694 8871
Fax +44 (0)20 7694 8429
mary.tokar@kpmgifrg.com

Ms Tricia O'Malley
International Accounting Standards Board
1st Floor
30 Cannon Street
EC4M 6XH

Our ref MT/288
Contact Mary Tokar

23 January 2009

Dear Ms O'Malley

Comment letter on Exposure Draft *Additional Exemptions for First-time Adopters – Proposed amendments to IFRS 1*

We appreciate the opportunity to comment on the International Accounting Standards Board's Exposure Draft *Additional Exemptions for First-time Adopters – Proposed amendments to IFRS 1 (ED)*. This letter expresses the views of the international network of KPMG member firms.

Overall we are supportive of the proposals. We support the Board's objective of addressing practical issues being faced by "Wave II" adopters of IFRSs. We believe that in principle these proposals fulfil one of the key objectives of IFRS 1, which is to help ease an entity's transition to IFRSs when the cost of retrospective restatement for a large group of first-time adopters is expected to outweigh the benefits thereof. However, we believe that two substantive changes are necessary to meet the intended objective:

- With respect to the proposed exemption for entities subject to rate regulation, we do not agree with the requirement to demonstrate impracticability. We note that other first-time adoption exemptions do not include such a limiting condition.

- As drafted, we do not believe that the proposed exemption for leases provides any relief because it relies on previous GAAP being "identical" to IFRIC 4 *Determining whether an Arrangement contains a Lease*. We believe that maintaining the term "identical" would, in effect, result in the proposed exemption being unavailable to any first-time adopter. We believe that the proposal should require that an entity's previous GAAP be "substantially aligned" with IFRSs.

Additionally, we believe that an exemption in respect of the designation of financial instruments at the date of transition should be considered by the Board. When such designation was made

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under previous GAAP, we believe that re-designation under IFRSs is punitive when the decision to adopt IFRSs is made after the date that would be the date of transition.

We also suggest a clarification in respect of the existing borrowing costs exemption and its interaction with other exemptions when the carrying amount of an asset includes borrowing costs capitalised under previous GAAP that are grandfathered upon the adoption of IFRSs.

The Appendix to this letter expands upon the above points in responding to the specific questions asked by the Board. Our responses also include a number of recommendations that we believe would clarify aspects of the proposals.

Please contact Mary Tokar or Julie Santoro at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix 1

Question 1

Do you agree with the proposed deemed cost option for entities using full cost accounting under previous GAAP? Why or why not? If not, what alternative do you propose and why?

As noted in our covering letter, we agree with the proposed exemption but recommend the clarifications discussed below.

Definition of full cost accounting

Currently there is no definition of full cost accounting in IFRSs and entities may have applied an accounting policy under previous GAAP similar to the description of full cost accounting in the proposals, but not labelled as such, e.g., "area of interest" accounting. We recommend that the amendments make it clear that the exemption is available based on the general description currently in the footnote to paragraph 19A rather than on use of the term "full cost accounting" itself.

Decommissioning liabilities

We believe that proposed paragraph 25EA, in respect of development and production assets, also should refer to exploration and evaluation (E&E) assets. In our experience, decommissioning obligations can be incurred in the E&E phase, e.g., "disturbance" from exploratory drilling.

Question 2

Do you agree with the proposed disclosure requirements relating to the deemed cost option for oil and gas assets? Why or why not?

We support the proposed disclosure requirement because it explains an entity's accounting policy selection.

Question 3

Do you agree with the proposed deemed cost option for entities with operations subject to rate regulation? Why or why not? If not, what alternative do you propose and why?

As noted in our covering letter, we agree with the Board's objective of providing relief in respect of property, plant and equipment used in operations subject to rate regulation. However, as explained below we do not agree with impracticability requirement.

Requirement to demonstrate impracticability

As noted in our covering letter, similar to other exemptions in IFRS 1, it is our understanding that the objective of this exemption is to ease an entity's transition to IFRSs and to avoid excessive cost (BC12 of the proposals). Therefore we do not agree with the requirement to demonstrate impracticability as a pre-condition to using this exemption; we note that other first-time adoption exemptions do not include such a limiting condition.

Mandatory impairment testing at the date of transition

The proposed exemption requires an entity to "…test each item for which this exemption is used for impairment in accordance with IAS 36…" The reference to testing "each item" might be read as contradicting the normal requirement to test for impairment at the lowest level of independent cash inflows, which might be a cash-generating unit that includes such an asset. To avoid confusion something like the following wording would be better:

> *At the date of transition to IFRSs, an entity shall apply IAS 36 to test for impairment those items to which this exemption is applied and, if necessary, reduce the carrying amount.*

Question 4

Do you agree with the proposal not to require the reassessment of whether an arrangement contains a lease in the circumstances described in this exposure draft? Why or why not?

As noted in our covering letter, overall we agree with the Board that relief from applying IFRIC 4 at the date of transition is appropriate when a similar assessment already has been made under previous GAAP. However, we question whether the proposal as written will provide relief.

Paragraph 25F refers to "the same determination under previous GAAP". IG206 further explains that an "identical" determination is required and that the transitional requirements must be "identical". While we agree with the Board's comment in BC14 that requiring a "similar" accounting would be problematic, we believe that "identical" is too strict a requirement. We have not been able to identify any jurisdictions that would be able to use the exemption as written currently.

We recommend using a phrase such as, "The requirements of previous GAAP are substantially aligned with IFRIC 4". The Basis for Conclusions then could explain that minor differences in wording that would not be expected to result in a different interpretation could be ignored, and that the respective transitional requirements need not be the same. Instead, the most relevant factor should be whether the arrangement was subject to an IFRIC 4-type assessment in determining the appropriate accounting under previous GAAP. For the same reason we recommend deleting the phrase "but at a date other than that required by IFRIC 4"; the date at which the assessment was made should not matter as long as the assessment was made for all arrangements existing at the date of transition.

In addition, we recommend making it clear that the exemption applies on an arrangement-by-arrangement basis as opposed to all arrangements.

Question 5

Do you agree that the situation referred to in Question 4 is the only one in which additional relief of this type is needed? If not, in what other situations is relief necessary and why?

We do not agree that lease arrangements are the only area in which relief of the type in paragraph 25F of the proposals would be appropriate.

Paragraph D19(a) of IFRS 1 (November 2008) refers to making an available-for-sale designation at the date of transition. Similarly, paragraph D19(b) refers to designating, at the date of transition, any financial asset or financial liability as at fair value though profit or loss if the relevant criteria in IAS 39 *Financial Instruments: Recognition and Measurement* are met. Other financial reporting frameworks may have a similar fair value option; one example is the fair value option available under UK GAAP, which is the same as the option under IFRSs but which may have been applied at a different date. The difficulty arises when an entity decides after the date that will be its date of transition that it will adopt IFRSs. It appears punitive not to allow use of the fair value option under IFRSs when a formal designation was made under previous GAAP, but was not made at the date of transition. Example wordings might be:

> *If an entity designated a financial asset as to be accounted for in the same way as an available for sale financial asset under IAS 39, then re-designation at the date of transition to IFRSs is not required.*
>
> *If an entity designated a financial asset or financial liability as at fair value through profit or loss under previous GAAP, and the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A of IAS 39 are met at the date of transition to IFRSs, then re-designation at the date of transition to IFRSs is not required.*

Other comments

The interaction of the transitional requirements of IAS 23 (2007) *Borrowing Costs* with the IFRS 1 exemptions is confusing and may result in diversity in practice. Therefore we recommend that the Board clarify that an entity applies the requirements of IAS 23 (2007) from the date of transition in respect of items to which other exemptions have been applied to allow an entity to grandfather the previous GAAP carrying amount at the date of transition.

In some cases it is clear that any borrowing costs capitalised under previous GAAP can be grandfathered. For example, in respect of the proposed exemption in paragraph 19B, it is clear that the entire carrying amount is grandfathered, and BC9 highlights that this may well include borrowing costs. However, in other cases it may be less clear, for example in relation to the exemption for service concession arrangements. While we interpret the service concession exemption to mean that any borrowing costs included in the grandfathered carrying amounts are themselves grandfathered, it would be helpful for this to be clear.

On the wider issue of the borrowing costs exemption in general, it would be helpful if the Board could clarify its intent with respect to the interaction of the IAS 23 (2007) transitional requirements and the related IFRS 1 exemption. Diversity in practice may result if some entities misinterpret the exemption as to whether or not a first-time adopter should grandfather, in the carrying amount of a qualifying asset whose construction is complete at the transition date, borrowing costs capitalised to such asset under previous GAAP using a methodology that differs from IAS 23.