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Dear Sir / Madam

Invitation to comment - Exposure Draft on Additional Exemptions for First-time Adopters: Proposed amendments to IFRS 1

Ernst & Young is pleased to comment on the above Exposure Draft (the “ED”).

Overall, we support the proposals to provide additional exemptions for first-time adopters. There are, however, specific areas within the ED where we believe additional clarity is needed. Additionally, we are concerned that some of the exemptions do not actually provide relief. These concerns are addressed within our responses to the specific questions posed by the Board, which are set out in Appendix A to this letter.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on 020 7951 3152.

Yours faithfully

Ernst & Young

Appendix A – Responses to specific questions raised in the Exposure Draft

Question 1—Deemed cost for oil and gas assets

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?

We support the proposed deemed cost option for entities using full cost accounting under their previous GAAP, as it provides a workable alternative for entities applying the full cost method.

However, paragraph 19A states "The entity shall *test* [emphasis added] exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition to IFRSs in accordance with IFRS 6 *Exploration for and Evaluation of Mineral Resources* or IAS 36 *Impairment of Assets* respectively…" Is it the Board's intent to require a full impairment test without first assessing whether there are indicators of impairment? Such an impairment test would require an entity to measure the value in use or fair value less cost to sell of the assets in question and largely negate the benefit of the exemption. We propose that the wording should be adjusted to state that "The entity shall *assess* [emphasis added] exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition to IFRSs in accordance with IFRS 6 *Exploration for and Evaluation of Mineral Resources* or IAS 36 *Impairment of Assets* respectively…" Under this approach an entity would first consider whether there are indicators of impairment and if so, only then perform an impairment calculation.

We also recommend that paragraph IG8 of the IFRS 1 implementation guidance be expanded to cover the additional deemed cost amounts introduced by paragraphs 19A and 19B. Additionally, we suggest that paragraph IG9 be amended as follows:

"Subsequent depreciation is based on that deemed cost and starts from the date for which the entity established the fair value measurement or revaluation, or from the date of transition to IFRSs in the case of the deemed costs amounts having been determined in accordance with paragraph 19A or 19B of the IFRS."

Question 2—Oil and gas assets—disclosure

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

While there is no harm in such a disclosure, we do not see what benefit such a disclosure would provide when it simply states the basis of allocation. It does not provide the financial statement user any additional insight regarding the balances in the financial statements. We believe the existing disclosure requirements in paragraphs 38 to 43 of IFRS 1, which require explanation of how the transition affected the financial statements, are sufficient.

Question 3—Deemed cost for operations subject to rate regulation

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?

We agree with the inclusion of an exemption to allow the use of previous GAAP carrying value as deemed cost for rate regulated assets.

However, the proposed exemption seems to provide limited relief, due to the inclusion of the IAS 8 'impracticable' threshold. That threshold only looks to whether the necessary historical information can be obtained after making every reasonable effort. Unlike paragraph BC12 in the basis for conclusions to the ED, it does not consider providing relief based upon a cost vs. benefit analysis. In practice, we would consider the IAS 8 definition of 'impracticable' to be a higher threshold to overcome and not consistent with a cost vs. benefit approach. Therefore, we recommend not restricting this exemption to an 'impracticable' threshold for rate regulated entities because:

- IFRS 1 does not apply the 'impracticable' condition in any other of its existing exemptions; and

- The IASB had considered the 'impracticable' condition in drafting the original version of IFRS 1. However, it was not carried through to the final version of IFRS 1 due to it being difficult to apply and the overall objective of IFRS 1 being to provide relief in first-time adoption of IFRS based primarily on the cost vs. benefit assessment.

Additionally, we believe there could be misunderstanding regarding the extent of the proposed exemption. We read the proposed exemption to relate only to the total value carried over from previous GAAP as deemed cost for rate regulated assets; and not to extend to other IAS 16 requirements, such as the requirements of paragraphs 43-46 of IAS 16 to separately depreciate each significant part of an asset. If a first-time adopter's previous GAAP did not require depreciation of each significant part of the asset as required by IAS 16, it may still incur significant costs to allocate the carrying value to those significant parts in order to prospectively depreciate each significant part. This may negate some of the benefit from the proposal to allow first-time adopters to use carrying values of rate regulated assets as deemed cost. The proposed exemption for oil and gas entities overcomes this issue by including a method for allocating carrying values to the underlying assets. Allocation of carrying values of rate regulated assets is not addressed in the ED. Therefore, a first-time adopter may read more into the proposed exemption. The Board should provide further guidance regarding practical application of this exemption. In any event, the Board should state clearly whether or not the use of this exemption by a first-time adopter extends to other requirements of IAS 16.

Similar to our comment regarding the impairment test for oil and gas assets in question 1 above, we have noted that paragraph 19B states "…an entity shall *test* [emphasis added] each item for which this exemption is used for impairment in accordance with IAS 36 *Impairment of Assets*…" We propose that the wording should be adjusted to state that "an entity shall *assess* [emphasis added] each item for which this exemption is used for impairment…" Under this approach an entity would first consider whether there are indicators of impairment and if so, only then perform an impairment calculation. Please refer to our response to question 1 for further discussion.

Question 4—Leases

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?

We agree with the inclusion of an exception to allow a first-time adopter to forego an IFRIC 4 reassessment of whether an arrangement contains a lease when the first-time adopter already made the same determination under previous GAAP, except at a different date. In such a scenario, this exemption would eliminate undue cost in performing an IFRIC 4 assessment at transition that would simply duplicate its previous efforts under previous GAAP.

However, we have noted inconsistencies in the ED's wording of the exemption in paragraph 25F, and the related implementation guidance and basis for conclusions in IG206 and BC 13, respectively. The portions of each of these paragraphs that prompt concern are highlighted as follows:

25F: "If a first-time adopter made the ***same determination*** under previous GAAP as that required by IFRIC 4 but at a date other than that required by IFRIC 4, the first-time adopter need not reassess that determination at the date of transition to IFRSs."

IG206: "If an entity applied previous GAAP requiring a ***determination identical*** to that required by IFRIC 4 ***and that previous GAAP had transitional provisions identical to those in IFRIC 4*** (the result being that the only difference in accounting is a different effective date from the one in the transition provisions of IFRIC 4)…"

BC13: "…Before adopting IFRSs, a jurisdiction might adopt a national standard identical to IFRIC 4, ***including the same transitional provisions***. An entity in that jurisdiction might then apply requirements ***identical*** to those of IFRIC 4 at the start of the earliest period for which comparative information is presented in accordance with the national standard."

Firstly, paragraph 25F of the ED uses the term 'same determination', while paragraph IG206 uses 'determination identical'. We recommend using the term 'determination identical' in both paragraphs to avoid potential differences in interpretation.

Secondly, we believe the Board's intent was that the 'assessment' under IFRIC 4 and previous GAAP should be identical, but not that the subsequent lease accounting must also be identical. For avoidance of doubt, the Board should not use the term 'accounting' as currently used in paragraph IG206. We have suggested modifications to paragraph IG206 below.

Thirdly, the introduction of the requirement in IG206 and BC13 for the transition requirements of the previous GAAP and IFRIC 4 to be the same (or identical) might have different interpretations. This issue is illustrated in the following example:

Pursuant to the transitional provisions of Emerging Issues Committee (EIC) 150 — *Determining Whether an Arrangement Contains a Lease*, a Canadian entity would have assessed all arrangements entered into subsequent to 9 December 2004 to determine if they contained a lease, with no requirement at transition to EIC-150 to reassess any ongoing arrangements it had previously entered into. For periods beginning on or after 1 January 2006, IFRIC 4's transitional provisions required either a full retrospective assessment or an assessment of all arrangements existing at the start of the earliest period presented in an entity's financial statements. In this scenario, the transition provisions of the two GAAPs are not identical and therefore it could be interpreted to mean that:

- the newly proposed exemption in paragraph 25F would not be applicable at all, due to the different transition requirements of the two standards; or
- the IFRIC 4 exemption proposed in the ED should be applied arrangement by arrangement, thus allowing the exemption to be applied to those arrangements that had been assessed under the previous GAAP. In this example, those arrangements still existing at the transition date to IFRS that had not been assessed under EIC-150 would need to be assessed under IFRIC 4 as of the transition date, pursuant to the currently existing IFRS 1 exemption regarding IFRIC 4.

We believe this exemption would be more useful, and advance the Board's goal of improving the practical application of IFRS 1, if it were to be applied arrangement by arrangement. We therefore recommend that paragraph IG206 be changed to the following:

"Paragraph 25F of IFRS 1 provides a transition exemption in addition to that discussed in paragraph IG205. If an entity applied previous GAAP to an arrangement that required a determination identical to that required by IFRIC 4, that entity may elect to use the determination in accordance with the previous standard for that arrangement. For arrangements existing at the transition date and for which an entity did not apply an identical determination to that required by IFRIC 4, it may apply the transition exemption discussed in paragraph IG205."

We also recommend that paragraph BC13 be modified as follows:

"…Before adopting IFRSs, a jurisdiction might adopt a national standard identical to IFRIC 4. An entity in that jurisdiction might then apply requirements identical to those of IFRIC 4 to some or all arrangements. However, on adopting IFRSs, IFRS 1 would require…"

It would also be helpful to include an example in the interpretive guidance to IFRS 1 outlining application of this exemption.

Question 5—Assessments under previous GAAP before the date of transition to IFRSs

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 are currently not aware of situations for which additional relief of this type is needed.