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International
Accounting Standards
Board



# INFORMATION FOR OBSERVERS

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| **IASB Meeting:** | **16 September 2008, London (Agenda Paper 9)** |
| **Project:** | **IFRS 1: First-time Adoption of IFRSs** |

## Objective

1. The objective of the discussion at the September 2008 IASB meeting is to resolve matters arising during balloting of the Exposure Draft of proposed additional exemptions for first-time adopters—proposed amendments to IFRS 1 and to approve a revised Exposure Draft.

## Action requested

2. IASB members are requested to reach decisions on the matters discussed in this Agenda Paper and, if considered appropriate, approve the revised Exposure Draft for issue.

## Materials provided

3. This Agenda Paper summarises the changes that have been made to the ballot draft previously distributed (July 2008) and analyses issues for which Board decisions are requested.

4. [Paragraph omitted from Observer Notes.]

## Analysis

5. Staff distributed a ballot draft to IASB Board members in July 2008. The following matters arose as a result of Board member review of that ballot draft:

   a. Some Board members questioned the need for the proposed exemption relating to IAS 17, Leases;

   b. Some Board members questioned the need for the proposed exception relating to fair value before the date of transition to IFRSs;

   c. Some Board members questioned the need for the proposed amendment to paragraph 25E(c) regarding decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment, as well as whether there are additional related issues;

   d. Some Board members questioned the inclusion in the Basis for Conclusions of arguments relating to the availability of qualified independent valuers and the use of fair values for oil and gas assets; and

   e. Some Board members questioned the inclusion of the question inviting comment on additional circumstances in which relief is necessary for assessments under previous GAAP before the date of transition.

6. In addition to the matters noted above, a number of drafting suggestions were made, resulting in the Basis for Conclusions, in particular, being significantly redrafted.

7. The following paragraphs analyse each of the issues noted in paragraph 5 and request decisions from the Board.

**Leases**

8. The July 2008 ballot draft proposed that, in addition to the proposal regarding IFRIC 4, *Determining whether an Arrangement contains a Lease*, a similar exemption be provided for a lease classified under previous GAAP as an operating lease or a finance lease at

inception, or subsequent modification, and for which the entity continued that classification through adoption of standards requiring exactly the same classification and transitional provisions as IAS 17 *Leases*. The July 2008 ballot draft proposed that the entity may maintain the previous GAAP classification for IFRSs. Some Board members questioned the need for the proposed exemption relating to IAS 17, Leases.

9. On further reflection, staff agree that this exemption is unnecessary. [Sentences omitted from Observer Notes.]

10. [Paragraph omitted from Observer Notes.]

11. Staff recommend that this exception is not needed and that the text relevant to IAS 17 should be deleted, with modifications made to refer only to the IFRIC 4 issue. Do IASB members agree?

**Fair value before the date of transition to IFRSs**

12. The July 2008 ballot draft proposed that an entity needing to determine fair values as at dates before the date of transition to IFRSs that were not required at those dates under previous GAAP shall use such fair values only if the information needed to determine them was available when IFRSs would have required them to be determined. If information needed to determine fair values was not available, an entity shall use the carrying amounts at those dates under its previous GAAP.

13. Some Board members questioned the interaction of this exception with other relief provided by IFRS 1. For example, it would place restrictions on the availability of the relief for business combinations when fair values were not previously available by limiting an entity’s ability to restate a past business combination when fair values are not available for more recent business combinations.

14. Furthermore, some noted that the proposal that "A first-time adopter shall use such fair values only if the information needed to determine them was available when IFRSs would have required them to be determined" does not impose the same discipline as other IFRSs which permit use of past fair values when "the entity has disclosed publicly the fair value

of ... determined at the measurement date." The proposed language in the July 2008 ballot draft implies that provided inputs were available, a calculation of fair value could be made today of conditions that existed in the past. There is some ambiguity as to whether any judgements needed to complete the valuation should also have been made at the measurement date. For example, would an internal memo recording the fair value amount have been subject to the same stringent reviews as information that was made public at the time.

15. Staff agree that the proposal to allow fair values from pre-transition dates only if the information needed to determine them was available when IFRSs would have required them to be determined would allow more use of fair values than would the language in IFRS 1, IFRS 2 & IAS 40. (The language used in the ballot draft was taken from IAS 39.107, which provides for an ability to do something that is not otherwise required.) However, if we were to limit the language to that in IFRS 1, IFRS 2 & IAS 40 we would exacerbate the problem with the interaction with other IFRS 1 relief. For example, it would become even more difficult for someone to restate a past business combination, thus narrowing that option, or to retrospectively restate anything else involving fair values. One possible solution to this problem could be to indicate that the other IFRS 1 exemptions come before this one, so as not to limit them.

16. Staff think that we should remind ourselves how we got to this proposal in the first place. The original objective was to provide some relief for retrospective accounting for items previously derecognised and now required to be recognised in accordance with IFRSs and also, perhaps, to alleviate the risk that some of these items might come back on balance sheet at values determined with the benefit of hindsight. Therefore, another possibility could be to develop material that would provide an exemption for items derecognised in accordance with previous GAAP required to be recognised in accordance with IFRSs. Perhaps that might say something along the lines of: "If an entity derecognised financial assets under its previous GAAP and those assets would not have been derecognised in accordance with IAS 39, but would be required to be measured at fair values in accordance with IAS 39, it shall not recognise those assets unless the entity has disclosed publicly the fair value of those assets at the date IAS 39 would have required that measurement."

17. On balance, staff recommend that we should delete the proposal regarding fair value before the date of transition to IFRSs from the July 2008 ballot draft. Do IASB members agree?

**Decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment**

18. Some Board members identified a difficulty for first time adopters in determining the adjustment to property, plant and equipment resulting from recognizing and measuring decommissioning liabilities in accordance with IAS 37. The difficulty arises because the portion of the liability that relates to having used an asset during a particular period for the purpose of producing inventories during that period is debited to inventory rather than to PP&E. Thus for any adjustment to the liability the offset needs to be apportioned between PP&E, inventory and cost of sales. First-time adopters may not have identified the production change separately from other measurement changes because that is not required by their existing standard. (Such identification is not required by US or Canadian standards.) As a result, it is possible that the change to paragraph 19A(b) that is being proposed for the entities using full cost accounting should be considered for all entities.

19. We have not yet been able to evaluate whether such a more pervasive change is needed. [Sentences omitted from Observer Notes.]

20. Furthermore, we are unsure that what is needed is only an amendment to IFRS 1. [Sentences omitted from Observer Notes.]

21. [Paragraph omitted from Observer Notes.]

22. [Sentence omitted from Observer Notes.]

23. We think that the Exposure Draft deals with the issue appropriately for operations subject to rate regulation and for oil and gas assets. We think that the broader issue can, more

appropriately, be considered as part of the Annual Improvements project, where it will also get more attention from constituents than in a project primarily directed to amending IFRS 1.

24. Do IASB members agree that this issue can be considered separately as part of the Annual Improvements project?

**Oil and gas assets**

25. Some Board members questioned the inclusion in the Basis for Conclusions of arguments relating to the availability of qualified independent valuers and the use of fair values for oil and gas assets. In particular they questioned the following text:

> "BC4 … Also this alternative might not be practicable if a jurisdiction with a large number of entities using full cost accounting adopts IFRSs, given the relatively small number of qualified independent valuers available to estimate fair value for a large number of assets in a limited transition period.
>
> BC5. The Board considered the results of research into the needs of users of financial statements presented by the project team for its research project on extractive activities. Most of the users of the financial statements of oil and gas entities who participated in the survey reported that they primarily want to estimate the value of the entity's equity and use estimated future cash flows to do so. These users viewed accumulated historical cost amounts of oil and gas assets as not useful for this purpose. Furthermore, they noted that, although using fair value as a deemed cost would provide more relevant information at the date of transition to IFRSs, it would have no more relevance than historical cost in subsequent years. In addition, the users surveyed stated that they would generally not use an entity-supplied fair value because of concerns that the entity's assumptions would differ from their own. Consequently, the Board concluded that the significant cost and effort of both existing approaches to determining the carrying amount of oil and gas assets at the date of transition to IFRSs would exceed the benefit to users."

26. AcSB staff think that these arguments provide important support for the proposed changes IFRS 1 (paragraph IN 4) states that IFRS 1 "grants limited exemptions from these requirements in specified areas <u>where the cost of complying with them would be likely to exceed the benefits to users of financial statements</u>" (emphasis added). Paragraphs BC 4 and BC 5 provide the cost-benefit arguments in support of the oil and gas proposal. Also,

they reflect views that were expressed or supported by other Board members during deliberations. We note that the Basis for Conclusions identifies that, “Individual Board members gave greater weight to some factors than to others.” We think that if these paragraphs reflect important rationale that individual Board members think support the proposals, then they should be included in the Basis for Conclusions. On the other hand, if all Board members agree they are not important, then they should be deleted.

27. Do IASB members agree that the text quoted in paragraph 24, above, should remain in the Basis for Conclusions?

**Question regarding additional circumstances in which relief is necessary for assessments under previous GAAP before the date of transition**

28. Some Board members questioned the inclusion of question 5, inviting comment on additional circumstances in which relief is necessary for assessments under previous GAAP before the date of transition.

29. Previously, some Board members explicitly requested that such a question be included in the Exposure Draft.

30. Do IASB members think that question 5 should be included in the Exposure Draft?