Project **IFRS 1 Exemptions**

Topic **Amendment to IFRS 7 Transitional Provisions**

Purpose

1. The staff received an inquiry with the interaction of the Board's recently completed *Improving Disclosures about Financial Instruments Amendments to IFRS 7 Financial Instruments: Disclosures* issued in March 2009 and IFRS 1 *First-time Adoption of International Financial Reporting Standards*. This agenda paper details the background on the inquiry received, provides the staff analysis and recommendation and requests the Board to respond to staff questions.

Background

2. In October 2009, the staff received an inquiry regarding the application of *Improving Disclosures about Financial Instruments* Amendments to IFRS 7 Financial Instruments: Disclosures. Specifically, the inquiry requested guidance on and relief from the provisions in IFRS 1 for first-time adopters that generally requires retrospective application of the current IFRS requirements to all periods presented in the first set of IFRS financial statements.

3. The inquirer notes its intent to convert its consolidated financial statements to IFRS for the year ending 31 December 2009 making the inquirer a 'first-time adopter' as defined by IFRS 1. The 'first IFRS reporting period' will be the year ended 31 December 2009 and the comparative reporting period will be the year ended 31 December 2008 with a 'date of transition to IFRSs' of 1 January 2008.

4. IFRS 1 states, in part:

> 7. An entity shall use the same accounting policies in its opening IFRS statement of financial position and throughout all periods presented in its first IFRS financial statements. Those accounting policies shall comply with each IFRS effective at the end of its first IFRS reporting period, except as specified in paragraphs 13–19 and Appendices B–E.
>
> 8. An entity shall not apply different versions of IFRSs that were effective at earlier dates. An entity may apply a new IFRS that is not yet mandatory if that IFRS permits early application.
>
> 9. The transitional provisions in other IFRSs apply to changes in accounting policies made by an entity that already uses IFRSs; they do not apply to a *first-time adopter*'s transition to IFRSs, except as specified in Appendices B–E.

5. The requirements in IFRS 1 are not consistent with the transition provisions afforded to current IFRS preparers adopting the amendment to IFRS 7. Paragraph 44G of IFRS 7 states, in part (emphasis added):

> …An entity shall apply those [*Improving Disclosures about Financial Instruments*] amendments for annual periods beginning on or after 1 January 2009. <u>In the first year of application, an entity need not provide comparative information for the disclosures required by the amendments</u>. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.

6. During the Board's redeliberation of the comments received on the exposure draft of *Improving Disclosures about Financial Instruments* at the January 2009 Board meeting, the Board deliberated the effective date and transition guidance for current IFRS preparers. Specifically, Agenda Paper 14C details the staff's analysis of the comments received regarding the proposed effective date and transition. That Agenda Paper includes several respondent comments including:

   (a) internal accounting systems would need to be adjusted to capture data required for the proposed fair value disclosures;

   (b) the required lead time particularly causes practical difficulties in providing comparatives for fair value disclosures; and

(c) providing an exemption from providing comparatives for first year adoption to entities that voluntarily early adopt.

7. In Agenda Paper 14C for the January 2009 meeting, the staff provided 4 alternatives relating to the effective date and transition. The staff recommended the effective date of 1 January 2009 with earlier application permitted. The staff also recommended eliminating the requirement to provide comparative information in the year of adoption of the amendment. The Board agreed with the staff recommendation which was subsequently incorporated into the final amendment issued in March 2009.

Staff Analysis and Recommendation

Objective of Staff Analysis

8. The staff analysis is to assist the Board in deliberating whether it desires to provide relief from the requirement in IFRS 1 to provide comparative information in accordance with the current IFRS requirements. I.e. Does the Board wish to provide an exemption to first-time adopters consistent with the transition provisions included in the amendment to IFRS 7 from the comparative period financial statement disclosures required by the amendment.

Staff Analysis

9. The staff notes that no formal analysis of *Improving Disclosures about Financial Instruments* on the impact to first-time adopters was included in the Board's redeliberations. However, the staff acknowledge the Board's primary objective of comparability in BC10 of IFRS 1 that states (emphasis added):

> SIC-8 gave priority to ensuring comparability between a first-time adopter and entities that already applied IASs. It was based on the principle that a first-time adopter should comply with the same standards as an entity that already applied IASs. However, <u>the Board decided that it is more important to achieve comparability over time within a first-time adopter's first IFRS financial statements and between different entities adopting IFRSs for the first time at a given date</u>; achieving comparability

> between first-time adopters and entities that already apply IFRSs is a secondary objective.

10. In the staff's opinion, the Board's primary objective of comparability can normally be implemented given the Board's desired lead time between issuing a final standard and the effective date of mandatory application. The Board frequently provides for a period of 6-18 months between the issue of a new standard and its mandatory effective date.

11. Additionally, the Board typically has not required preparers to present comparative information that would impose costs out of proportion to the benefits to users or increase the risk that preparers might need to make arbitrary assumptions in applying hindsight. The Board's dislike of the use of hindsight is evidenced in paragraphs 41 and 42 of IAS 1 *Presentation of Financial Statements* that requires comparative information unless impracticable.

12. *Improving Disclosures about Financial Instruments* was issued in March 2009. The transition provisions note that comparative information need not be disclosed in the year of adoption. The Board's rationale included in paragraph BC5A of IFRS 7 states, in part:

> …The Board decided to require application of the amendments for periods beginning on or after 1 January 2009. The Board noted that, although the effective date of IFRSs and amendments to IFRSs is usually 6–18 months after issue, the urgent need for enhanced disclosures about financial instruments demanded earlier application.

Staff Recommendation

13. In the staff's opinion, the lack of normal lead time (usually 6-18 months from issue to effective date) necessary to require enhanced disclosures in an urgent manner precludes most entities from presenting comparative information without significant effort and potential hindsight. This view is supported by the comment letters received on the exposure draft of *Improving Disclosures about Financial Instruments* as summarised in the staff analysis (January 2009 Board Agenda Paper 14C).

14. In the staff's opinion, this same exemption from comparative information in the year of adoption should be provided to first-time adopters with adoption dates in 2009. These first-time adopters would be in the same position as existing IFRS preparers and would not have known about the amendment until after the comparative period had already passed.

15. The Board has made similar IFRS 1 exemptions from comparative year application. This includes amendments to IAS 39 that were not finalised until 2004. In that instance BC89A to IFRS 1 states, in part:

> … The Board was sympathetic to concerns that entities that will be required to comply with IFRSs for the first time in 2005 could not make a timely transition to IFRSs because IAS 39 will not be issued in final form until after the start of 2004. Therefore, the Board decided to exempt entities adopting IFRSs for the first time before 1 January 2006 from producing comparative information that complies with IAS 32 and IAS 39, as revised in 2003, in their first IFRS financial statements.

16. Therefore, the staff recommends an amendment to Appendix E *Short-term exemptions from IFRSs* to IFRS 1 to permit entities adopting IFRSs for the first time before 1 January 2010 to apply the transition provisions in paragraph 44G of IFRS 7 in their first IFRS financial statements.

Questions for the Board

17. The staff have the following questions for the Board:

Question 1 – Amendment to IFRS 1
Q1. Does the Board agree with the staff recommendation to amend IFRS 1 to state that an entity need not provide comparative information required by *Improving Disclosures about Financial Instruments* for first-time adopters adopting before 1 January 2010?

Question 2 – Addition of topic to Board agenda
Q2. Does the Board agree with the staff recommendation to add this topic to the Board's agenda?

Exposure Draft

18. Provided the Board concludes that this topic should be added to the Board's agenda, the staff requests the Board provide the staff with guidance on additional issues for this topic.

Proposed project timeline

19. If the Board agrees to proceed with the amendment as recommended by staff, we propose the following timetable:

    (a) Approve project, approach and proposed wording of the amendment at the November meeting.

    (b) Ballot draft circulated week commencing 23 November.

    (c) Exposure draft issued week commencing 7 December with a 30 day comment period.

    (d) Analysis of comment letters presented at January 2010 Board meeting and amendment finalised.

    (e) Final amendment balloted and issued late January or early February.

Question 3 – Project timetable
Q3. Does the Board agree with the project timetable proposed by the staff?

Proposed effective date

20. The staff also recommends that the final amendment be effective 90 days after it is published with early adoption permitted. Because of the importance of this issue to first-time adopters, we recommend that the intended effective date be included in the exposure draft rather than being left open for future determination.

21. Therefore, the staff recommends that the final amendment be effective for annual periods beginning on or after 1 June 2010. The staff also recommends

that earlier application is permitted; however, if an entity applies the proposed amendment before 1 June 2010, it shall disclose that fact.

Question 4 – Proposed effective date
Q4. Does the Board agree with an effective date requiring that an entity shall apply this amendment for annual periods beginning on or after 1 June 2010 with early adoption permitted?

Drafting and balloting

22. Subject to the Board's agreement with prior staff recommendations, the staff request approval to proceed with this project including drafting and to provide the Board with a ballot for publication of an exposure draft.

Question 5 – Authorisation to proceed with drafting and to ballot
Q5. Does the Board approve the staff to proceed with this proposed amendment including drafting and a ballot to be provided to the Board for publication of an exposure draft?

Appendix A – Proposed Drafting

A1. Provided the Board agrees with the staff's recommendations, the staff proposes draft wording for the exposure draft. All Board edits/ comments are appreciated in preparation for the exposure draft balloting.

A2. The staff propose the following amendment to Appendix E *Short-term exemptions from IFRSs* to IFRS 7 *First-time Adoption of International Financial Reporting Standards*.

In Appendix E, a heading and paragraph E1 are added.

Disclosures about Financial Instruments

E1 A first-time adopter may apply the transitional provisions in paragraph 44G of IFRS 7 to the extent that the entity's first IFRS reporting period is earlier than 1 January 2010.

In the Basis for Conclusions on IFRS 1, paragraph BC89B is added.

BC89B In March 2009 the Board amended the disclosure requirements about financial instruments. Noting the urgent need for enhanced disclosures about financial instruments, the Board demanded earlier application than the usual 6-18 months after issue of a final standard and required application of the amendments for period beginning on or after 1 January 2009. However, the Board acknowledged the concerns received about a short implementation date and decided to provide that in the first year of application, an entity need not provide comparative information for the disclosures required by the amendments. In [month year] the Board considered the effects of this amendment on first-time adopters and decided the same transition provisions should be applicable to the extent that the entity's first IFRS reporting period is earlier than 1 January 2010.