Project	**Annual Improvements – 2008-2010 cycle**
Topic	**Comment letter analysis: IFRS 1 *First-time Adoption of International Financial Reporting Standards* – fair value or revaluation as deemed cost exemption**

Summary Overview

1. Included in the exposure draft of proposed *Improvements to IFRSs* published in August 2009 was a proposed amendment to clarify the scope of the exemption in paragraph D8. The objective of this paper is to obtain a final IFRIC decision to allow this issue to be included in the final *Improvements to IFRSs* planned to be issued in April 2010. This agenda paper:

   a. provides **background** information on the issue,

   b. **analyses the comments received** as part of the exposure draft process and **recommends any changes** to the proposed draft wording, and

   c. **requests the IFRIC to confirm** whether they agree with the staff's recommendations.

Background

2. Paragraph D8 of IFRS 1 currently permits a first-time adopter to use a revaluation basis as 'deemed cost' when an event such as a privatisation triggered a revaluation at or before the date of transition to IFRSs.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IFRIC.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRIC or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

Decisions made by the IFRIC are reported in IFRIC *Update*.

Interpretations are published only after the IFRIC and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

3. During 2009, the Board received a request to extend the exemption in paragraph D8 of IFRS 1 for a continuing business restructured in connection with a privatisation and subsequent initial public offering (IPO). In some jurisdictions, local laws require the new entity formed as a result of the associated restructuring process to revalue its assets and liabilities to fair value, and further, to treat the revalued amounts as deemed cost. Under IFRS 1 as it currently stands, the new entity will have to prepare two sets of figures for its assets and liabilities, from its first year of IFRS adoption onwards – one to comply with its selected policies under IFRS, and one to comply with the local 'deemed cost' laws.

4. This issue was presented to the Board in June 2009 (staff paper 13D *Accounting for Privatisation*; *http://www.iasb.org/NR/rdonlyres/76F745BD-A2B8-4D91-943C-00EF7FD89083/0/AIP0906b13Dobs.pdf*). The Board agreed to amend paragraph D8, not out of a need to ease transition for an entity which plans its IFRS adoption ahead of time, but more for those entities where transition to IFRS is triggered by a privatisation and IPO process.

5. The proposed amendment extends the exemption in paragraph D8 to be applicable to events *occurring after transition date, but before the end of the entity's first IFRS reporting period*. The entity would be able to use the event-driven fair value measurement as deemed cost for IFRS purposes from then onwards, and would not need to maintain two sets of figures.

6. In this paper, the staff discusses and analyses the comments received from constituents during the comment period which ended on November 24, 2009.

Comment Letter Analysis

7. The Board received 55 comment letters on the ED. 16 of these included a specific comment directly related to this issue.

8. The comment letters received were mostly supportive of the general intention behind the amendment to paragraph D8. However, particular areas requiring staff analysis were the following:

a. Comparative periods,

b. Recognition of the event-driven revaluation in the accounts, and

c. Effective date of the amendment.

Comparative periods

9. Several of the respondents disagreed with the Board’s decision that the event-driven fair value measurement could only be applied from the event date. The entity would still need to establish the IFRS cost or a deemed cost (paragraphs D5 – D7 of IFRS 1) for an asset at the date of transition. The respondents stated that this would be burdensome for the first-time adopter, which they say is contrary to the purpose of IFRS 1 - to provide relief to the entity adopting IFRS for the first time.

10. A number of comment letters preferred the ‘work back’ or ‘roll back’ approach for comparative presentation purposes (referred to as Option A in the June 2009 Board paper). This approach involves adjusting the event-driven fair value measurement ‘backwards’ for depreciation, amortisation, additions and disposals, and any impairment to the date of transition, to establish the deemed cost at transition. Respondents consider it a more ‘practical and cost-efficient solution’. The respondents also noted that the ‘work back’ approach would have the effect of ensuring that assets and liabilities were consistently measured between transition date and subsequently, consistent with the principle in paragraph 7 of IFRS 1.

11. The Board rejected the ‘work back’ approach on the basis that use of hindsight could have a significant effect on the results reported in particular circumstances, and also that the derived figure at the date of transition is unlikely to be fair value at that date, or a reconstructed IFRS historical cost number. Some respondents acknowledged the issues around use of hindsight; however, they consider providing relief on transition to be of greater importance.

Staff analysis and recommendation on the comparative period issue

12. The staff think that the reasons for the Board rejecting the 'work back' approach at the June meeting remain valid - the 'work back' approach may be inappropriate in circumstances where the event-driven fair value measurement is significantly different to the fair value at transition date. No new facts or arguments have come to light during the comment process, therefore re-deliberation of this issue is not considered necessary.

13. **The staff recommend clarifying the wording in paragraph D8 for the rationale explained in paragraphs 3 and 4. The wording should continue to reflect the Board's intentions at the June 2009 meeting with respect to comparative periods.**

Recognition of the event-driven revaluation

14. Some respondents indicated a need for clarification of how the event-driven revaluation would be recognised in the accounts of the entity – once the adjustment for the deemed cost has been made to the asset or liability, where should the other side of the entry be recorded? Respondents indicated that guidance here would be useful, to avoid diversity of treatment in practice.

Staff analysis and recommendation on the recognition issue

15. The staff agree that this guidance would be useful. The staff think that the adjustments should be recognised directly in retained earnings, with separate disclosure of the effect in the Statement of Changes in Equity. The relief in D8 is given for the purpose of adoption of IFRS. Typically, any adjustments that are required as part of the IFRS adoption process are recorded either in retained earnings (or, if appropriate, another category of equity), and the staff see no basis for exception to this principle.

16. **The staff recommend that paragraph D8 be amended to reflect where the adjustments should be recognised.**

Effective date

17. A number of respondents commented on the application provisions in paragraph 39B. Some respondents found the wording unclear and were unsure of which entities were included. Others disagreed with the provisions of the paragraph, as drafted - they suggest that the Board 'reconsider the transitional requirements…as we do not believe that unlimited retrospective application is appropriate', and that the amendment be 'restricted to an entity's first IFRS financial statements'.

Staff analysis and recommendation on the effective date issue

18. The staff note that the intention of paragraph 39B is *to allow existing IFRS preparers, whose restructuring for a privatisation occurred in the past, but within the period covered by the first set of IFRS financial statements prepared in accordance with IFRS 1*, to apply the proposed amendment to paragraph D8 retrospectively. The Board agreed to allow this in order to provide the requested relief, as discussed in paragraphs 4 - 5. The staff would like to emphasise that the relevant entities *are not required* to apply the proposed amendment, but can *choose to do so*.

19. The staff agree, however, that the wording in paragraph 39B could be made clearer to reflect the Board's intention, **and this is the staff's recommendation**.

Summary and question for the IFRIC

20. The staff recommends that the IFRIC proceed with the amendment.

21. The staff's recommended changes to the draft wording and a draft basis for conclusions are included as appendices:

    a. Appendix A shows the proposed amendment, including the staff's recommendations in this paper, highlighting differences from the currently effective standard; and

    b. Appendix B shows revisions to the wording in the previously published exposure draft, following staff's recommendations in this paper.

22. The staff also recommends that the proposed amendment be finalised for inclusion within the final *Improvements to IFRSs* expected to be issued in April 2010.

Question for the IFRIC
Does the IFRIC agree with the staff recommendations to the Board and the proposed amendment in Appendix A? If not, what does the IFRIC recommend, and why?

Appendix A – Draft wording of the proposed amendment, showing differences from the currently effective standard

Proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

In Appendix D paragraph D8 is amended (new text is underlined and deleted text is struck through).

Fair value or revaluation as deemed cost

D8 A first-time adopter may have established a deemed cost in accordance with previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatisation or initial public offering. ~~It may use such event-driven fair value measurements as deemed cost for IFRSs at the date of that measurement.~~

(a) If the measurement date is *at or before* the date of transition to IFRSs, the entity may use such event-driven fair value measurements as deemed cost for IFRSs at the date of that measurement.

(b) If the measurement date is *after* the date of transition to IFRSs, but during the period covered by the first IFRS financial statements, the event-driven fair value measurements may be used as deemed cost when the event occurs. An entity shall recognise the resulting adjustments directly in retained earnings (or if appropriate, another category of equity) at the event date. The entity may establish the deemed cost at the date of transition to IFRSs by applying the criteria in paragraphs D5-D7, or it may measure assets and liabilities at date of transition in accordance with the other guidance in this IFRS.

Paragraph 39B is added.

Effective date

39B *Improvements to IFRSs* issued in [date] amended paragraph D8. An entity shall apply those amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact. Entities that applied IFRS 1 in a previous period are permitted to apply the amendment to paragraph D8 retrospectively in the first annual period after the amendment is effective. An entity applying paragraph D8 retrospectively shall disclose that fact.

Amendment to Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraphs BC46A and BC46B are added

Fair value or revaluation as deemed cost

BC46A As part of its annual improvements project 2008 - 2010, the Board reconsidered the scope of paragraph D8. In some jurisdictions, an entity that becomes a first-time adopter of IFRS through a privatisation and IPO process, is required by local laws to revalue its assets and liabilities to fair value, and also to treat the revalued amounts as deemed cost. Therefore, from its first year of IFRS adoption onwards, the new entity would have to prepare two sets of figures for its assets and liabilities – one to comply with its selected policies under IFRS, and one to comply with the local 'deemed cost' laws. The Board considered this to be unduly onerous. Therefore, the Board proposed to amend paragraph D8 to allow the entity to recognise the event-driven fair value measurement as deemed cost when the event occurs, provided that this is during the periods covered by its first IFRS financial statements.

BC46B The Board also decided to require the entity to present historical costs or other amounts already permitted by IFRS 1 for the periods before that date. In this regard, the Board considered an approach where an entity could 'work back' to the deemed cost on the date of transition, using the revaluation amounts obtained on event date, adjusted to exclude any depreciation, amortisation or impairment between the two dates. Although some believed that this presentation gives better comparability throughout the first IFRS reporting period, others object to it on the basis that making such adjustments requires hindsight and the computed carrying amounts on the date of transition are neither the revalued assets' historical costs nor their fair values on that date.

Appendix B – Draft wording showing changes from the exposure draft published in August 2009 following the staff's recommendations in this paper

Proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

In Appendix D paragraph D8 is amended (new text is double-underlined and deleted text is double-struck through).

Fair value or revaluation as deemed cost

D8 A first-time adopter may have established a deemed cost in accordance with previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatisation or initial public offering.

(a) If the measurement date is *at or before* the date of transition to IFRSs, ~~end of the first IFRS reporting period~~, the ~~first-time adopter~~ entity may use such event-driven fair value measurements as deemed cost for IFRSs at the date of that measurement.

(b) If the measurement date is *after* the ~~first-time adopter's~~ date of transition to IFRSs, but during the period covered by the first IFRS financial statements, the ~~entity~~ event-driven fair value measurements may be used as ~~elect a~~ deemed cost when the event occurs. ~~at the date of transition that meets the criteria in paragraphs D5–D7.The event-driven fair value measurement within the~~ An entity~~'s~~ shall recognise the resulting adjustments directly in retained earnings (or, if appropriate, another category of equity) at ~~first IFRS reporting period is recognised as deemed cost when~~ the event date. ~~occurs.~~ The entity may establish the deemed cost at the date of transition to IFRSs by applying the criteria in paragraphs D5-D7, or it may measure assets and liabilities at date of transition in accordance with the other guidance in this IFRS.

Paragraph 39B is added (new text is double-underlined and deleted text is double-struck through).

Effective date

39B *Improvements to IFRSs* issued in [date] amended paragraph D8. An entity shall apply those amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted. If an entity~~ had first~~ applies~~d IFRSs in an earlier period, the entity is permitted to apply ~~the amendment for an~~ to paragraph D8 in the first annual period after the amendment is effective as if it had been available in that ~~earlier period, it shall disclose that fact. Entities that applied IFRS 1 in a previous period are permitted to apply the amendment to paragraph D8 retrospectively in the first annual period after the amendment is effective. ~~If~~ A~~a~~n entity appl~~ies~~ying paragraph D8 retrospectively ~~the amendments for an earlier period it~~ shall disclose that fact.

Basis for Conclusions on proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

~~***This Basis for Conclusions accompanies, but is not part of, the proposed amendments.***~~

Paragraphs BC46A and BC46B are added

Fair value or ~~R~~revaluation basis as deemed cost

BC46A As part of its annual improvements project ~~in 2009~~ 2008 - 2010, the Board reconsidered the scope of paragraph D8. ~~At that time, paragraph D8 was applicable to events such as~~ In some jurisdictions, an entity that becomes a first-time adopter of IFRS through a privatisation ~~or~~ and an initial public offering (IPO) process ~~that took place before the date of transition to IFRSs, but not if the event was later.~~ is required by local laws to revalue its assets and liabilities to fair value, and also to treat the revalued amounts as deemed cost. Therefore, from its first year of adoption onwards, the new entity would have to prepare two sets of figures for its assets and liabilities – one to comply with its selected policies under IFRS, and one to comply with the local 'deemed cost' laws. The Board considered this to be unduly onerous. ~~The Board concluded that its reasons for granting the exemption in paragraph D8 were equally valid for such events that occurred after the date of transition to IFRSs but during the periods covered by the first-time adopter's first IFRS financial statements.~~ Therefore, the Board propose~~d~~s to amend paragraph D8 to ~~reflect that conclusion.~~ allow the entity to recognise the event-driven fair value measurement as deemed cost when the event occurs, provided that this is during the periods covered by its first IFRS financial statements.

~~BC5 When deliberating comparative presentation for the proposed amendment, one option the Board considered requires an entity to establish the deemed cost on the date of transition to IFRSs using the revaluation amounts subsequently obtained~~

~~on the date of measurement, adjusted to exclude any depreciation, amortisation or impairment between the date of transition to IFRSs and the date of that measurement. That would result in the balances on the date of measurement approximating the revaluation amounts. Although some believe that this presentation gives better comparability throughout the first IFRS reporting period, others object to it on the basis that making such adjustments requires hindsight and the computed carrying amounts on the date of transition are neither the revalued assets' historical costs nor their fair values on that date.~~

BC46B ~~Therefore, t~~The Board decided to require ~~an~~ the entity to ~~establish the deemed cost as of the event-driven fair value measurement date and, for the periods before that date,~~ present historical costs or other amounts already permitted by IFRS 1~~.~~ ~~The Board notes that this proposed presentation overcomes the use of hindsight. It also presents supportable carrying amounts for such assets on the date of transition that are broadly consistent with the existing requirements of IFRS 1 and with the principle of the transition. Because any significant adjustments related to an event that triggers such a revaluation would already be highlighted in the first IFRS financial statements and disclosures, the proposed presentation clearly identifies the effects of any significant difference in depreciation or amortisation between the periods before and after the date of measurement.~~ for the periods before that date. In this regard, the Board considered an approach where an entity could 'work back' to the deemed cost on the date of transition, using the revaluation amounts obtained on event date, adjusted to exclude any depreciation, amortisation or impairment between the two dates. Although some believed that this presentation gives better comparability throughout the first IFRS reporting period, others object to it on the basis that making such adjustments requires hindsight and the computed carrying amounts on the date of transition are neither the revalued assets' historical costs nor their fair values on that date.