STAFF PAPER

IFRS Interpretations Committee Meeting

May 2013

Project	***2011–2013 Annual improvements Cycle* (ED November 2012)—Comment letter analysis**
Topic	**IFRS 1 *First-time Adoption of International Financial Reporting Standards*—Meaning of effective IFRS**

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Introduction

1. The Exposure Draft ED/2012/2 *Annual Improvements to IFRSs 2011–2013 Cycle* published in November 2012 ('the ED') includes a proposal for an amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* to clarify the meaning of 'each IFRS effective at the end of an entity's first IFRS reporting period', as used in paragraph 7 of IFRS 1.

Objective

2. The objective of this paper is to provide an analysis of the comment letters received on the proposal to amend IFRS 1 and to obtain a recommendation from the IFRS Interpretations Committee (the Interpretations Committee) for the IASB to include the amendment in the final *Annual Improvements to IFRSs* that is planned to be published in 2013.

Structure of the paper

3. This paper:

   (a) provides a description of the issue that led to the proposed amendment;

   (b) analyses the comments received as part of the Exposure Draft process; and

(c) asks the Interpretations Committee to confirm whether it agrees with the staff recommendation to proceed with the proposed amendment.

Description of the issue

4. The Interpretations Committee received a request to address an issue related to the meaning of 'effective' in paragraph 7 of IFRS 1. The submitter noted that, if there is a new Standard that is not yet mandatory, but that can be adopted early, there may be two possible versions of a Standard that are effective at the end of an entity's first IFRS reporting period. Consequently, an entity may:

   (a) have the choice between applying an old Standard or adopting a new one;

   (b) be required to apply the new Standard only; or

   (c) be required to apply the old Standard only.

5. This question has arisen because of a perceived discrepancy between paragraphs 7 and BC11 of IFRS 1.

6. Paragraph 7 of IFRS 1 states [emphasis added]:

   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.

   This would imply that the entity has a choice between using a current version of a Standard or adopting a new version early (where permitted to do so).

7. Paragraph BC11 of IFRS 1 states [emphasis added]:

   BC11 Paragraphs 7–9 of the IFRS require a first-time adopter to apply the **current** version of IFRSs, **without considering superseded or amended versions**. This:

   (a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;

   (b) gives users comparative information prepared using later versions of IFRSs that the Board regards as superior to superseded versions; and

   (c) avoids unnecessary costs.

This would imply that the entity should use the new version of the Standard, and goes on to explain why this is recommended. This submitter, therefore, requested clarification of the meaning of the word 'effective' as used in paragraph 7 of IFRS 1.

8. At the May 2012 meeting, the Interpretations Committee agreed that an entity has the choice between applying an old Standard or adopting a new one. If a new Standard is not yet mandatory but permits early application, that Standard is permitted, but not required, to be applied in the entity's first IFRS financial statements, provided that the same version is applied throughout the periods covered by the entity's first IFRS financial statements. The Interpretations Committee observed that the requirement in paragraph 7 is clear, but paragraph BC11 needs clarification through the Annual Improvements project to avoid unnecessary misunderstanding.

9. Consequently, the Interpretations Committee decided to recommend that the IASB should amend paragraph BC11 by adding a new paragraph in the Basis for Conclusions.

10. At the June 2012 meeting, the IASB decided to include the amendment proposed by the Interpretations Committee in the ED.

Comment letter analysis

11. In this section, we discuss and analyse the comments received from interested parties on the ED during the comment period, which ended on 18 February 2013.

12. The ED asked two general questions that were answered individually for each proposed amendment:

    (a) *Question 1: Do you agree with the IASB's proposal to amend the Standard as described in the Exposure Draft? If not, why and what alternative do you propose?*

(b) *Question 2: Do you agree with the proposed transitional provisions and effective date for the issue as described in the Exposure Draft? If not, why and what alternative do you propose?*[1]

13. The IASB received 65 comment letters on the ED in total; 60 respondents expressed their views on the proposed amendment to IFRS 1.

Analysis of Question 1

14. With respect to Question 1, about 70 per cent of the respondents who replied to this question agreed with the proposed amendment to IFRS 1.

15. The reasons why some of those respondents support the IASB's proposal are shown below:

    (a) The proposed improvement to the Basis for Conclusions would eliminate the apparent contradiction between paragraphs 7 and 8 of the Standard and paragraph BC11 of the Basis for Conclusions (GLASS, ESMA, FACPCE, CINIF and ICPAK).

    (b) The IASB is not proposing to amend the Standard, and we agree with this as the Standard (paragraphs 7 and 8) is clear enough on the meaning of effective IFRS (RSM).

    (c) The proposed amendment will enhance comparability while facilitating financial reporting presentation on the same time-basis (EFFAS).

    (d) The proposed amendment provides clarification of previously agreed conclusions (AFME).

16. Some respondents disagreed, or partially agreed, with the proposal to amend the Basis for Conclusion of IFRS 1. The main reasons of these respondents are as follows:

    (a) The respondent does not see the proposed amendment as a necessary update to improve clarity. Paragraph 8 of IFRS 1 is already clear. To the extent that the IASB determines the amendment to be necessary, the respondent suggests

[1] This question is not applicable to this proposed amendment, because the IASB is proposing to amend the Basis for Conclusions of IFRS 1. Consequently, this proposal does not include any transition provisions or effective date.

that the improvements should be made directly to the Standard rather than to the Basis for Conclusions (PwC, SwissHoldings, Roche, Baker Tilly, HKICPA, FAR, Nestle, HKAB).

(b) The proposed amendment does not meet the annual improvement criteria, because it does not clarify or correct the Standard. When the Standard is clear, the IASB should use its resources to amend non-authoritative material. Conversely, if it is not clear, the Standard should be revised rather than the Basis for Conclusions. The Basis for Conclusions should then explain why a change was made. The proposed new paragraph BC11A is incomplete as it does not explain what entities that choose to adopt a newly issued Standard early in the year of first-time adoption of IFRS should do or not do. Paragraph 9 of IFRS 1 prohibits a first-time adopter from applying the transition requirements in a standard except as specified in Appendices B–E. Thus, IFRS 1 might require retrospective application when a new Standard would otherwise require prospective application in the year of adoption. For example, IFRS 13 *Fair Value Measurement* requires prospective application as the use of hindsight would be required if an entity applied the Standard retrospectively. Therefore, we think by modifying paragraph BC11 and adding paragraph BC11A, more confusion could occur (AcSB).

(c) The Basis for Conclusions is not part of the Standard and is not endorsed/included in national regulations (AcSB, Baker Tilly, Repsol, EFRAG and BDO).

17. Few respondents think that the proposed wording of paragraph BC11 should be improved. The main suggestions are as follows:

(a) According to the first sentence of the current paragraph BC11, a first-time adopter is required to apply “the current version of IFRSs, without considering superseded or amended versions”. This implies that the entity should use the most recent version of a Standard. The advantages of using the most recent version of a Standard are explained in the second sentence of this paragraph in (a)–(c). The IASB proposes to amend the first sentence of paragraph BC11 to clarify that a first-time adopter is not required to apply the most recent but "a single" version of each Standard. The advantages explained in (a)–(c), however, derive only from applying the most recent version of a Standard (GASB).

(b) The proposed wording of paragraph BC11 should be improved. Paragraph 7 of IFRS 1 makes reference to "all periods presented in its first IFRS financial statements"; while paragraph BC11 makes reference to "each period presented". The respondents believe that use of the word "each" may be interpreted to mean that a different version of a Standard may be applied for each period, rather than the same version for each and every period presented. Accordingly, the respondent suggests that paragraph BC11 should be amended to refer to "all periods" instead of "each period" (SAICA and Moore Stephens).

18. We have summarised the concerns above as follows:

(a) do not amend the Basis for Conclusions; and

(b) wording suggestions.

19. We will analyse the concerns that we have identified above in the following paragraphs.

Do not amend the Basis for Conclusions

20. Some respondents think that the IASB should not amend the Basis for Conclusions because:

(a) paragraph 8 of IFRS 1 is already clear;

(b) the Basis for Conclusions on IFRS 1 is not authoritative, it summarises the IASB's considerations in reaching the conclusions in IFRS 1; and

(c) the Basis for Conclusions is not endorsed/included in national regulations, so divergence in practice will continue.

21. They think that the proposed amendment is unnecessary. However if the IASB thinks that additional guidance is necessary, then this guidance should be provided in the Standard rather than in the Basis for Conclusions.

22. We think that to solve this issue we should amend the Basis for Conclusions, because:

    (a) the Standard is already clear; and

    (b) this issue has arisen because of a perceived discrepancy between IFRS 1 and the Basis for Conclusions.

23. We also think that this amendment is necessary because the Basis for Conclusions describes the rationale of the IASB's decision. A Standard should be read in the context of its Basis for Conclusions and, therefore, the Basis for Conclusions should be consistent with the Standard. In our view, a Basis for Conclusions that is not consistent with its Standard can cause divergence in practice, even though it is not authoritative.

Wording suggestions

24. One respondent noted that the advantages explained in paragraph BC11, derive from applying "the most recent version" of a Standard and not from "a single version" of each Standard.

25. We agree with this observation. This is confirmed by our proposed paragraph BC11A that states [emphasis added]:

    … **Notwithstanding the advantages set out in paragraph BC11 of applying a more recent version of an IFRS**, paragraphs 7 and 8 permit an entity to use either the currently mandatory IFRS or the new IFRS that is not yet mandatory, if that IFRS permits early application…

26. Two respondents suggested that paragraph BC11 should be amended to refer to "all periods" instead of "each period" because:

    (a) paragraph 7 of IFRS 1 makes reference to "all periods presented in its first IFRS financial statements"; and

    (b) the word "each" may be interpreted to mean that a different version of a Standard may be applied for each period, rather than the same version for each and every period presented.

27. We agree with these suggestions and our proposed changes are highlighted in Appendix B of this paper.

Staff recommendation

28. On the basis of the analysis in the previous section of this paper, we think that the Interpretations Committee should recommend to the IASB that it should proceed with the proposed amendment to the Basis for Conclusions of IFRS 1, which clarifies that: an entity has the choice between applying an old Standard or adopting a new one. If a new Standard is not yet mandatory but permits early application, that Standard is permitted, but not required, to be applied in the entity's first IFRS financial statements, provided that the same version is applied throughout the periods covered by the entity's first IFRS financial statements.

29. Appendix A shows the proposed final amendment, highlighting differences from the currently effective Standard.

30. Appendix B shows revisions to the wording in the previously published Exposure Draft.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree to recommend to the IASB that it should proceed with the amendment to the Basis for Conclusions of IFRS 1?
2. Does the Interpretations Committee agree with the proposed wording of the amendment as shown in Appendix A of this paper?

Appendix A—Proposed final amendment to IFRS 1

A1. The proposed final amendment to the Basis for Conclusions of IFRS 1 is presented below.

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

The IASB proposes to amend the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*, which is not part of the Standard, by amending paragraph BC11 and adding paragraph BC11A. New text is underlined and deleted text is struck through.

BC11 Paragraphs 7–9 of the IFRS require a first-time adopter to apply ~~the current~~ a single version of each IFRS~~s~~, throughout all periods presented in its first IFRS financial statements ~~without considering superseded or amended versions~~. Applying a more recent version of an IFRS~~This~~:

(a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;

(b) gives users comparative information that was prepared using later versions of IFRSs that the IASB regards as superior to superseded versions; and

(c) avoids unnecessary costs.

BC11A Paragraph 7 requires an entity to use the IFRSs that are effective at the end of its first IFRS reporting period. Paragraph 8 allows a first-time adopter to apply a new IFRS that is not yet mandatory if that IFRS permits early application. Notwithstanding the advantages set out in paragraph BC11 of applying a more recent version of an IFRS, paragraphs 7 and 8 permit an entity to use either the currently mandatory IFRS or the new IFRS that is not yet mandatory, if that IFRS permits early application. Paragraph 7 requires an entity to apply the same version of the IFRS throughout the periods covered by the entity's first IFRS financial statements. Consequently, if a first-time adopter chooses to early apply a new IFRS, that new IFRS will be applied throughout the periods presented in its first IFRS financial statements, unless this IFRS provides an exemption or an exception that permits or requires otherwise.

Appendix B— Changes from the Exposure Draft published in December 2012

A2. The proposed final amendment to the Basis for Conclusions of IFRS 1 is presented below. New text that is proposed to be added, is shown with a double-underline. Text that is proposed to be deleted with respect to the proposed amendment included in the ED (December 2012), is shown with a ~~double-strike through~~.

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

The IASB proposes to amend the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*, which is not part of the Standard, by amending paragraph BC11 and adding paragraph BC11A. New text is underlined and deleted text is struck through.

BC11 Paragraphs 7–9 of the IFRS require a first-time adopter to apply a single version of each IFRS, throughout all ~~each~~ periods presented in its first IFRS financial statements. ~~This:~~ Applying a more recent version of an IFRS:

(a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;

(b) gives users comparative information that was prepared using later versions of IFRSs that the IASB regards as superior to superseded versions; and

(c) avoids unnecessary costs.

BC11A Paragraph 7 requires an entity to use the IFRSs that are effective at the end of its first IFRS reporting period. Paragraph 8 allows a first-time adopter to apply a new IFRS that is not yet mandatory if that IFRS permits early application ~~adoption~~. Notwithstanding the advantages set out in paragraph BC11 of applying a more recent version of an IFRS, paragraphs 7 and 8 permit an entity to use either the currently mandatory IFRS or the new IFRS that is not yet mandatory, if that IFRS permits early application. Paragraph 7 requires an entity to apply the same version of the IFRS throughout the periods covered by the entity's first IFRS financial statements. Consequently, if a first-time adopter chooses to early apply a new IFRS, that new IFRS will be applied throughout the periods presented in its first IFRS financial statements, unless this IFRS provides an exemption or an exception that permits or requires otherwise.