

International Accounting Standards Board
30 Cannon Street
London
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United Kingdom

30 October 2002

Dear Sir

Exposure Draft ED1 - First time Application of International Financial Reporting Standards

We are responding to the invitation to comment on the above exposure draft on behalf of the worldwide organisation and Global IAS Board of PricewaterhouseCoopers.

We support the general objectives of ED1: to provide limited relief in the manner in which an entity first applies International Financial Reporting Standards. We agree with the inclusion of a limited number of narrowly defined exemptions from full retrospective application. However, the current ED1 over complicates the way in which the principles including the exemptions apply, and the ED does not clearly describe the option to use the SIC-8 approach. ED1 needs a clear articulation of the two alternative approaches and it needs to be redrafted.

Articulation of Principles

IFRS standards should be based on clearly articulated principles. There are two alternative principles that an entity might follow to adopt IFRS for the first time. These principles are as follows:

- An entity may apply IFRS for the first time, as if it had always applied IFRS (retrospective application or the 'SIC 8 approach'), as implied by the current paragraph 13 of ED1; or
- An entity may apply IFRS for the first time using relief in specified limited areas of application (as articulated throughout ED1) using the current version of IFRSs.

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ED1 should start with a statement of these basic principles. The structure of a re-drafted standard would follow on. These principles are consistent with the conceptual basis of the Board's approach to this topic. That is, to offer some relief to large groups of preparers of financial statements who are required to adopt IFRS, while not sacrificing consistency, quality and comparability.

The existing structure of ED1 should be improved by specifying more clearly the other principles (the bold-print paragraphs) it contains. At present only paragraphs 7, 25 and 30 are in bold print. The objective should be that each paragraph in bold print is intended to express a principle followed by text in light type that explains that principle. The following should be in bold print: paragraphs 1, 2 (first sentence only), 7, 10 (first sentence only), 12 (second sentence only), 13 (third sentence only), 14 (first sentence only), 30 and 38 (first sentence only). Paragraph 25 appears to be in the wrong place and should be integrated with paragraph 7 since it is part of the process of applying IFRS accounting policies.

Undue cost or effort

We have previously expressed our concerns (our letter to you dated 9 September 2002 on the Improvements exposure draft), with regard to the phrase "undue cost or effort". Absent clarification, a wide diversity of practice will arise in the interpretation of 'undue cost or effort' ranging from very lenient to very strict. This diversity of practice may significantly undermine the Board's objective of comparability.

The Board should provide some parameters to allow preparers and auditors to assess what undue cost or effort might mean. The explanatory material in paragraph BC13 is helpful and should be included in ED1, but limited further elaboration and examples would be useful.

Use of exemptions

We support the Board's proposals for balancing the costs and benefits of gathering information for the first time application of IFRS. However, the current drafting of ED1 over complicates both the way in which the exemptions are articulated and how they are

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exposure draft of revised IAS 1.

- (2) Paragraph 2 (b). There are situations where a limited group of owners of an entity receive the financial statements but no external parties receive them. We suggest
- (3) changing the wording to “prepared but not previously published financial statements under IFRS” and the remainder of (b) should be deleted.
- (4) Paragraph 3 (c). We do not believe that it is appropriate in an IFRS to refer to the auditors’ report. The exposure draft should focus on principles, and references to auditors, if necessary, should be dealt with in the implementation guidance along with further explanation. We suggest replacing the wording “but the auditors qualified their audit report on those financial statements with “but those financial statements did not comply with IFRSs in certain specific respects”.
- (5) Paragraph 4. The opening sentence and section (a) are not necessary because this exposure draft does not apply to existing IFRS preparers. Section (b) of paragraph 4 should be integrated into paragraph 9.
- (6) Paragraph 5. We do not support the exemption for certain subsidiaries. Subsidiaries almost always report to their parent on group reporting forms for inclusion in the consolidation, but frequently do not prepare complete financial statements for group purposes. The amounts reported by a subsidiary for inclusion in consolidation will often differ from the amounts reported in the subsidiary’s separate financial statements; for example, when the parent has recorded fair value adjustments on acquisition that are held in the subsidiary’s books for group reporting purposes but not for the subsidiary’s separate financial statements. Further, the materiality level used in the preparation of group reporting forms may often be significantly higher than the materiality level that would be applied if the entity had to prepare individual financial statements for publication/filing. The concession in paragraph (b) has no conceptual basis, particularly if the wholly owned subsidiary has quoted debt or preference shares. We suggest that the Board deletes all of paragraph 5. Subsidiaries should follow the same rules as all other first-time adopters.
- (7) Paragraph 5(a). For clarity, in line 2 replace “they” with “the consolidated financial statements”.

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applied. Further it does not distinguish between those exemptions that are mandatory (which might more properly be termed 'exceptions') and those, which are only available if 'undue cost or effort' is involved. We comment in our response to Question 2 on specific aspects of the exemptions.

Retrospective application

The proposed status of SIC 8 is not clear from ED1. We recommend that the standard include a separate (brief) section incorporating material from SIC 8 explaining how retrospective application should be applied when the exemptions are not used. We do not believe that this belongs in the 'exemptions' section.

The interaction between paragraphs 7, 8 and 13 is confusing, as paragraphs 8 and 13 effectively override the principles set out in paragraph 7. Paragraph 13 needs to be rewritten to make its meaning clearer. We recommend that paragraph 7 is expanded to include the requirements of paragraphs 8 and 13.

Question 1

The proposed IFRS would apply when an entity first adopts International Financial Reporting Standards (IFRSs) as its new basis of accounting, by an explicit and unreserved statement of compliance with all IFRSs (paragraphs 1-5 and paragraphs BC4-BC10 of the Basis for Conclusions).

Is this an appropriate description of the circumstances when this proposed IFRS should apply? If not, what changes would you suggest, and why?

Yes, in general we support the description. However, we have the following specific comments:

- (1) Paragraph 2. The first sentence suggests that "annual" financial statements are for a 12-month period. The word "annual" may confuse. There may be full interim financial statements or an entity's first IFRS financial statements may be for a 9 or 15 months period. We suggest the word "annual" is deleted. More suitable wording is to refer to "complete" set of financial statements as used in paragraph 6 of the

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Question 2

The proposed IFRS proposes a requirement that an entity shall prepare its opening IFRS balance sheet using accounting policies that comply with each IFRS effective at the reporting date for its first IFRS financial statements. Paragraphs 13-24 propose limited exemptions from this requirement.

Are all of these exemptions appropriate? Should the Board amend any of these exemptions or create any further exemptions (paragraphs BC11-BC89)? If so, why?

See our comments under “Use of exemptions” above. Should the Board decide to retain the exemptions in their current format, we have the following comments:

- (1) If an entity follows the limited exemptions approach, some exemptions appear to be mandatory (e.g. financial instruments and IAS 19) whereas others only apply if determining a cost-based approach requires undue cost or effort. So the exemptions appear to have different qualities and therefore need to be distinguished. The mandatory exemptions generally represent exceptions from retrospective application rather than exemptions. They exist to avoid cherry picking and to improve comparability. By contrast the “undue cost or effort” exemptions represent “relief” for first-time adopters. The draft should emphasise that these two types of exemption serve different purposes.
- (2) Paragraph 9. An entity has to apply the IFRS in force at 31 December 2005 retrospectively to the opening IFRS balance sheet. However, the proposed IFRS does not deal with the implications for first-time adopters of IFRSs that become effective after the date of first time adoption and require prospective application (although paragraph BC88 has a passing reference to this point). For example, the date of first time adoption for an SEC foreign registrant (which must file three years of income statements) might be 1 January 2003. The Board has concluded that IAS 22 (revised) will be applied prospectively from the date of adoption. An existing IAS preparer and a first-time adopter not using the exemptions will apply it prospectively (probably from a date in the second half of 2003). A first-time adopter using the exemptions will apply it retrospectively to 1 January 2003. The Standard should include some consequential changes to address the impact on first-time adopters of the proposals to revise IAS 22.

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- (3) Paragraph 14 (a). The IASB should clarify and emphasise in the text that an entity should apply the recognition criteria under IFRSs before moving on to consider using any exemptions.
- (4) Paragraph 16. We agree with the logic of the Board's argument, however the wording of the second sentence conveys a negative image. Most entities do have fixed asset registers but it is the level of detail in the registers about individual fixed assets that may not give sufficient data.
- (5) Paragraph 17. The use of indices is not necessarily the most suitable surrogate for fair value. We suggest deleting paragraph 17. Paragraph 15 already explains clearly that when fair value is used, it should be assessed having regard to the principles in IAS 22. Paragraph 14(b) should be strengthened to stress that any valuations used should be consistent with the fair value methodology of IAS 22.
- (6) Paragraph 18. We think it unlikely that a company will not have records of each individual investment property, given that the focus of such an activity should be on monitoring rental yields by property. Further, as explained in comment (4) above, the use of indices is not necessarily the most suitable surrogate for fair value. We suggest deleting the first sentence in paragraph 18 and the references to investment property in the last sentence of paragraph 18 and the first sentence of paragraph 35.
- (7) Paragraph 20. We do not see the benefit of forcing an entity to use the business combination exemption. This exemption should not be mandatory. Companies that wish to retrospectively apply IAS 22 for whatever reason should be allowed to do so.
- (8) Paragraph 21 line 7. For clarity, after "adjustment" insert "in the opening IFRS balance sheet".
- (9) Paragraph 22. We agree with this exemption and this is the only logical approach to accounting for such plans at the date of transition to IFRSs.
- (10) Paragraph 23. We do not understand the basis for this exemption. The CTA amounts in previous GAAP might be inappropriate as these amounts are affected by other adjustments that may have been made to foreign entities' assets and liabilities in order to meet the IFRS recognition rules. We suggest a similar approach to that followed on the adoption of IAS 21.48 in 1995: namely, if the amount is not

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reasonably determined, the CTA account is set to zero and movements are shown prospectively from the date of first-time adoption.

- (11) Paragraph 23 line 5. To be consistent with the terminology used elsewhere, replace “undue cost and effort” with “undue cost or effort”.
- (12) Paragraph 24. The reference to “hedging requirements” does not appear appropriate. Hedge accounting is optional and not a requirement, and may only be applied when the criteria for application have been satisfied. We suggest the text is modified to read: “As more fully explained in Appendix C, an entity may only apply hedge accounting as per IAS 39 Financial Instruments: Recognition and Measurement, provided that the requirements for application of hedge accounting were met, prospectively from the date of transition to IFRSs.”

Question 3

Paragraphs 28-37 of the proposed IFRS deal with presentation and disclosure requirements (see also paragraphs BC90-BC97). Are all of these disclosures appropriate? Should the Board require any further disclosures or eliminate or amend any of the proposed disclosure requirements? If so, why?

In general, we support the disclosure requirements. However, we have the following comments:

- (1) The opening IFRS balance sheet should be included in a footnote in the first IFRS financial statements alongside the commentary (required by paragraph 32) which explains the material adjustments. The text should encourage a columnar analysis to show clearly the adjustments made to each line item. A similar columnar analysis should be encouraged for the closing (final) balance sheet published under previous GAAP and the profit and loss account for that year. However, we believe that the requirement in paragraph 32 to analyse the adjustments into changes in policies, changes in estimate and correction of errors is excessive.
- (2) We believe that entities will find it impractical to explain material adjustments to the cash flow statement and the disclosures given may not be very meaningful. We suggest that this requirement is deleted. Instead entities should provide a reconciliation of previous GAAP cash or cash and cash equivalents to the IAS 7

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definition of cash and cash equivalents, with appropriate commentary.

- (3) The transition to IFRS, for some entities, may involve significant change to their reportable segments (business and / or geographical) and to designation of items as discontinuing operations. We recommend that entities should explain material adjustments to previously reported segments and changes in designation of items as discontinuing operations.
- (4) Entities should explain any changes from previous GAAP in the composition of the denominator in EPS calculations under IFRS because of the importance of EPS data to users of accounts. (Changes in the numerator will have been addressed in the reconciliation required by paragraph 31 (b)).
- (5) Paragraph 36. The discussion of historical summaries should be moved to the draft implementation guidance. The Standard should focus on the requirements of financial statements.
- (6) Paragraph 37. The disclosures for the first interim period seem excessive and will require 3 equity and 2 income reconciliations. IAS 34 does not require the full prior financial year profit figures, only the comparable interim period (current and year-to-date). Yet paragraph 37(b) requires inclusion of the reconciliation (paragraph 31(b)) of the full prior financial year profit figures. We suggest the reconciliation is limited to the opening balance sheet at start of implementation and the prior period (half year) P&L figures already reported.

Question 4

Do you have any other comments on the Exposure Draft?

- (1) Paragraph 6. The text of this paragraph and the example in paragraph 8 represent guidance and should be included in the implementation guidance.
- (2) Paragraph 25, line 4. Insert "between previous GAAP and IFRS " after "accounting policies". A similar suggestion applies to IG16, line 4. This would help to confirm for example that the actuarial assumptions on transition to IFRS have to be compliant with IAS 19.

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- (3) Paragraph 26. The IASB should include an additional example here as an entity will generally be able to access external published rates. An additional example might refer to provisions (e.g. lawsuits), where no account should be taken of the subsequent outturn (in the lawsuit). Paragraph 26 should also clarify that the goodwill impairment test must be performed based on conditions that existed at the date of the transition and cannot include the benefit of hindsight.
- (4) Paragraph 26. This paragraph is potentially confusing even with the guidance in BC89. It suggests that estimates should not reflect conditions arising after the transition date. However, IAS 10 requires that adjusting events do consider conditions arising after the balance sheet date. Paragraph 26 should be redrafted to explain clearly how IAS 10 operates on first-time application of IFRS.
- (5) Paragraph 38. If the Board finalises the IFRS in quarter 2 of 2003 (as implied by IASB Insight – July 2002), we believe that the proposed effective date for periods beginning on or after 1 January 2003 is too ambitious for first-time adopters, especially those with quarterly or half-year reporting under IAS 34. We recommend that the Board mandate an effective date for periods beginning on or after 1 July 2003, with early adoption encouraged.
- (6) Appendix A. We question the need for this list of terms. These terms are used in the exposure draft and the reader can find them in the Glossary.
- (7) Appendix B, B1 (b) line 3. The text needs to clarify that the entity first has to establish that the individual assets and liabilities acquired meet the recognition criteria before considering how they are measured under IFRS. This could be achieved by inserting after “business combination” the words “and that meet the recognition criteria of IFRS”.
- (8) Appendix B, B1 (d) line 3. We suggest that the Board gives an example of a measurement basis that is not cost-based. Insert after “measurement” the following “(for example, because measurement at fair value is required)”.

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- (9) The final sentence in this paragraph B1 (d) of Appendix B is difficult to follow. It is trying to address a fundamental issue, that of recognition under IFRS. The IASB should rewrite this section, setting out firstly that the entity applies normal tests of recognition criteria, before considering the measurement rules and any potential exemptions.
- (10) Similar to the guidance contained at IG11 and IG28, the implementation guidance should include a short section on IAS 27/SIC-12 to explain that at the date of transition to IFRSs an entity classifies its subsidiaries (including any SPEs) on the basis of circumstances existing at the date of acquisition.
- (11) The treatment of assets and obligations arising from finance leases acquired in a business combination does not seem appropriate. We read ED1 to state that if they were not recognised under previous GAAP at the date of the business combination, they cannot be recognised in the IFRS opening balance sheet and consequently in subsequent IFRS financial statements. A finance lease acquired in a business combination that was not recognised under previous GAAP should not be recognised in the IFRS opening balance sheet, as the amount assigned to the lease at that moment was nil and IAS 17 requires a cost-based measurement of assets and liabilities relating to a finance lease (paragraph 20(a) and B2 (example 4). BC41 confirms that this is a departure from the principle (paragraph 11(a)) that the opening IFRS balance sheet should include all assets and liabilities according to the IFRS definitions and criteria.
- (12) IG 42 to IG 49. This will need to be updated for the proposed amendments to IAS 39.
- (13) The ED alternates between using "IFRS" and "IFRSs". We suggest using "IFRS" consistently throughout the standard on the basis that it is a collective noun that can be used in both the singular and plural.

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If you have any questions in relation to this letter please do not hesitate to contact Jochen Pape, Chair of the PwC Global IAS Board (49 211 981 2905), or Mary Dolson (44 207 804 2930).

Yours faithfully



PricewaterhouseCoopers