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UK Member of  
Grant Thornton International

National Office

Our Ref BRS/NH

International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH

31 October 2002

Dear Sirs

## **ED 1 - FIRST TIME APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS**

We are in broad agreement with the general thrust of these proposals. In particular, we commend the Board on keeping them simple and the list of exemptions relatively restricted. If extensive lists of exemptions and circumstances were produced, it would be an encouragement to entities adopting IFRS for the first time to seek to argue their way to what they believed was a good presentation of their position. Such an approach could well lead to a reduction in the quality of implementation of IFRS generally.

In particular, we agree with the hierarchy of objectives that the Board sets out in BC16. In our view, a counsel of perfection will not aid the Board's wider objectives for IFRS to become the international benchmark on accounting.

We have concerns about the phrase "undue cost or effort". At face value it appears to be a weaker requirement than the concept of impracticability in SIC 8 that it replaces. The rationale for "undue cost or effort" is hidden in BC13, and not stated firmly enough there. We recognise the need for some concept of this type, but recommend strongly that its meaning and intent be stated clearly in the standard. Quite apart from the scope for abuse, we are not convinced that all adoptions of IFRS will be carried out with as much forewarning as that in the European Union and thus the expectation that planning will begin on a timely basis may not be borne out in practice.

Another issue on "undue cost or effort" is the inter-relationship between ED 1 and its use in IAS 1 and IAS 8, both of which are concerned with changes in accounting policies and presentation. IAS 1 and IAS 8 both allow general exemption from obtaining comparative figures, after reasonable effort, on the grounds of undue cost or effort. ED 1 makes specific allowance in a limited number of cases, on these grounds. It would be helpful to explain clearly whether the general exemption in IAS 1 and IAS 8 applies also in the case of first-time application.

Finally, we would recommend greater clarity in some of the key provisions of the proposals, particularly the impact of the choices in paragraphs 8 and 13, and the implications of

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applying those exemptions. Specifically, we understand that the essential implementation choice is between:

- Preparing the first IFRS financial statements as if IAS/IFRS had always been used, and
- Preparing them using the IFRS effective at the reporting date, and using all the exemptions listed that are applicable.

If we have read it right, it would improve understanding, and hence implementation, if this were clearly stated. We detail this further below, together with answers to the specific questions posed.

## **RESPONSES TO SPECIFIC QUESTIONS**

### **Question 1**

We agree that the IFRS should apply when an entity first adopts IFRS as its new basis of accounting by an explicit and unreserved statement of compliance with all IFRS.

### **Question 2**

Before dealing with the specific exemptions detailed in paragraphs 13-24, there is a matter of clarity about the options available. The construction of paragraphs 7-14 makes it quite complicated for the reader to understand what options are being given. In particular:

- paragraph 8 refers to paragraph 13 applying, but paragraph 13 describes both options of using the exemptions or not
- paragraph 14 introduces the items in paragraphs 15-24 as exemptions, whereas those in (a) are requirements, those in (b) are permission, and those in (c) are prohibitions. It would be helpful if these were clearer
- it is not immediately clear that the requirements in paragraph 11 are not overridden by the exemptions (for example, under paragraph 20(a) a provision arising from a business combination would appear to be carried forward at its previous GAAP carrying amount, but this may be prohibited under paragraph 11(b), despite the introducing phrase "except as described in paragraphs 13-24")
- it would be much more helpful to spell out clearly the two essential options (ie either prepare the opening IFRS balance sheet as if IFRS had always been used, or use the IFRS effective at the reporting date for the first IFRS financial statements, using the listed exemptions).

We have the following comments on the exemptions that have been given, or not given.

In groups where goodwill arising on acquisition of a foreign entity has been treated as an asset by the parent and not retranslated annually, the exemption in paragraph 20(b) would mean that no adjustment would be made to the goodwill figure and it would remain translated at the historic rate at the date of acquisition. It is not clear how there could be any subsequent retranslation to give effect to paragraph 45 in the proposed revised version of IAS 21. Perhaps this could be clarified.

We note the reasons given in BC 78 for not permitting finance lease income under IAS 17 to be applied prospectively only. This is a tough call, but we agree with the Board's decision on the grounds that if prospective application were permitted in this case, there would be calls for a similar treatment in many other cases.

BC 71 supports the conclusion that there should be no "undue cost or effort" exemption in circumstances where there has been hyperinflation. However, these may be circumstances where a considerable amount of past data collection would be needed. Perhaps it would be possible for a simpler alternative to be allowed, such as taking fair values at the date of coming out of hyperinflation as deemed cost.

Convertible debt is required to be split and presented partly in debt and partly in equity, under IAS 32. Where such debt was issued some time back, it may now be difficult to make the estimates necessary to establish the initial equity element. An exemption could be considered for this case.

### **Question 3**

We consider the proposed disclosures to be appropriate and well expressed.

### **Question 4**

We have concerns that the expectation of the Board expressed in BC 13, that first-time adopters will begin planning on a timely basis for the transition to IFRS, will not be so in practice. It may be so for the listed companies affected by the EU regulation, but in other countries application of IFRS may be mandated with little time available for planning, and indeed at a time when the date of transition to IFRS has already passed. Such entities will have a problem.

We do not propose that the basis on which the exposure draft is drawn up be radically altered. However, we believe that the discussion of "undue cost or effort" should be expanded to accommodate the implications for such entities. Also, if it is intended that the phrase represents a real difficulty in obtaining the information as well as a cost/benefit test, then these concepts should be more fully expressed, and placed in the standard itself, and not just the basis for conclusions.

When this standard is issued, it will supersede SIC 8, being a superior requirement. Since an entity is only a first time adopter once, and because an entity choosing a new accounting policy must choose the best one available, it would seem to follow that once this draft is issued as a standard, a first time adopter should choose to apply it rather than SIC 8. (The

only exception would be if the accounts were issued within a few days of the publication of the final standard).

Depending on when the standard is finally issued, it may be appropriate to reflect this in the effective date paragraph, either by requiring a tighter effective date, or requiring disclosure of why SIC 8 was followed after date of publication of this standard. Otherwise entities could choose to adopt IFRS under SIC 8 to gain supposed advantage under the transitional provisions, particularly as regards prospective application.

Although not listed in the exemptions, we question the implementation guidance on IAS 10. In the example given after IG 2 an assessment is made of the provision from a court case. The events occurred in September 2004, and the entity was found liable in June 2005. In preparing its December 2004 accounts (perhaps in March 2005) no provision was made because the entity expected to win the case. The analysis given is that if previous GAAP was consistent with IAS 37 then the restated balance sheet at December 2004 does not include a provision. However, if previous GAAP was not consistent with IAS 37, then the evidence from the resolution of the court case, which was only available in June 2005 after the 2004 accounts had been prepared, confirms that there was a liability at December 2004. This seems to us to be abusing hindsight - the evidence that changed the estimate was not available until after the date of preparation of the accounts. We dislike the conclusion.

## **DETAILED COMMENTS**

We have the following detailed comments.

Paragraph 20(b) requires goodwill to remain at its previous carrying amount (subject to the matters in (b) (i) and (ii)). If under previous GAAP goodwill in respect of a foreign acquisition was carried at historical foreign currency exchange rate, it is not clear when would be a logical time for such an amount to transfer to the closing rate method proposed by IAS 21 (revised).

Paragraph 20 (b)(ii) requires that the impairment loss arising from the impairment test on goodwill be recognised, but is not explicit as to where. We presume that it is reflected in the reconciliation statements rather than in the first profit and loss account after the date of transition, but it would be helpful to say.

B1 states that paragraph 20 of the draft IFRS prohibits application of IAS 22 retrospectively. This is only true if the exemptions are used and could be more helpfully drafted.

In B1(e) it is stated that there shall be no negative goodwill in the opening IFRS balance sheet. However, if IAS 22 is not applied retrospectively, and negative goodwill arose under the previous treatment and is not eliminated under 20(b)(i), then it is not currently clear what an entity would do with its reported negative goodwill.

C1 (like B1) states that paragraph 24 requires an entity to apply hedging requirements prospectively. As above, this only applies if the exemptions are used.

C2 and C3 refer to transactions being designated as hedges under previous GAAP. It is not clear what would count as such a designation - presumably the intent is not that the IAS 39 criteria should be used, but rather that some form of identification allowed under previous GAAP should suffice. It would be helpful if this were clarified.

Yours faithfully

A handwritten signature in black ink, appearing to read "Grant Thornton". The signature is fluid and cursive, with the first name "Grant" and the last name "Thornton" clearly distinguishable.

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