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International Accounting Standards Board
30 Cannon Street
London
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Dear Sirs

**LSCA TECHNICAL COMMITTEE RESPONSE TO ED 1 FIRST-TIME
APPLICATION OF INTERNATIONAL FINANCIAL REPORTING
STANDARDS**

With a membership of over 37,000, the London Society of Chartered Accountants (LSCA) is the largest of the regional bodies which form the Institute of Chartered Accountants in England & Wales. London members, like those of the Institute as a whole, work in practice or in business. The London Society operates a wide range of specialist committees including Technical (accounting and auditing) and it is that Committee which has recently considered the text of the Exposure Draft on First-time application of International Financial Reporting Standards and wishes to make the following comments and observations to the International Accounting Standards Board, including responses on specific questions asked in the Exposure Draft.

Our answers to the detailed questions are set out in the appendix.

GENERAL COMMENTS

Structure of the standard

This is the first draft standard produced by the IASB and we have concerns with the precedent being set in terms of structure and authority of content. Putting aside the basis of conclusions, the standard consists of three sections; main standard, appendices and implementation guidance. The standard, whether black or grey letter text, is mandatory. The appendices are an integral part of the standard and so are also mandatory. The implementation guidance is not part of the standard but contains further explanation. Presumably it is not mandatory, but its status is not entirely clear. We do not expect that implementation guidance should generally be included with new standards; however, we see no difficulty in doing so as long as its status is clearly denoted.

The draft standard is not very long and the appendices contain material that could have been included in the main body of the standard. Indeed, apart from examples that should be included in the implementation guidance, Appendix B merely repeats paragraph 20 of the standard except that it includes additional paragraphs (a) and (e) and an additional sentence in paragraph (b). These additional points are important and should have been included in the main standard; it is unclear why they were not. We would also recommend that the part of example 4, which clarifies that goodwill that was originally deducted from equity should not be reinstated to assets, should be moved from the implementation guidance to the standard.

We do not consider this structure, with its duplication and unnecessary multitude of parts to the standard, to be helpful and the structure of the final standard and implementation guidance, including the status of the various parts, should be reviewed before the standard is issued. In the UK, before black-letter standards were developed, standards contained further explanatory material that tended to be repetitive since it had to repeat the requirements of the standard before explaining them. It would be a retrograde step for international standards to become repetitive in a similar way. We believe that the IASB should be able to develop a structure for its standards and other material that uses the best aspects of the different approaches of national standard setters. We suspect that, unfortunately, this draft standard represents instead the results of a compromise that fails the tests of clarity, succinctness and usefulness.

We also question the decision to publish three documents rather than one, giving rise to extra costs. We do not believe that this method should be used for future documents.

Clarity of the text

It takes a reasonably detailed analysis of the draft standard, and particularly the interaction of paragraphs 7, 8 and 13, to work out that, broadly speaking, preparers have a choice of approach, i.e. between full retrospective application of IAS and limited retrospective application, but using all the exemptions in the standard. We suggest the IASB may like to reconsider making this clearer within the main text of the standard, but at the very least the introduction could make the overall approach of the standard clear, which it fails to do at the moment. In the main body of the text, it would be much clearer if paragraph 13 were bold, because in fact it is not an explanation of the principle of full retrospective application in paragraph 7. Rather, it is a completely different approach to first time application. The Board may not wish to describe them as such, but in fact paragraphs 7/8 represent a "benchmark treatment" and paragraphs 13 and following are an "allowed alternative".

We suggest that paragraph 13 at least be redrafted, for the sake of clarity for users, as bold letter along the lines of: "An entity may choose not to follow paragraphs 7 and 8 when preparing its first IFRS financial statements. Instead, it may:

- (a) apply the latest version of IFRSs; and
- (b) use all the exemptions given in paragraphs 14-24."

The first two sentences of the current paragraph 14 should also be included in the revised paragraph 13, leaving the rest of that paragraph to explain the different exemptions. Some consequential redrafting of other paragraphs may also be required.

First-time application of IAS 39

While we believe that theoretical purity would require first-time adopters to prepare their opening IFRS balance sheet in accordance with IAS 39, including having designated and documented hedges in accordance with that standard, it must be acknowledged that this is not practical and, in some cases, is simply not possible. For example, EU listed companies with registrations in the US would be required to prepare opening IFRS balance sheets as at 1 January 2003 in order to prepare the 2003 comparatives required in 2005. Not only is there insufficient time between now and the end of the year to put IAS 39 compliant systems into place to designate hedges, but IAS 39 is in the process of revision and the content of the final standard will not be known with certainty until after 1 January 2003.

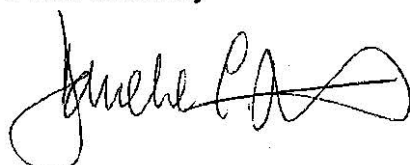
We are therefore of the opinion that some transitional provisions are necessary and, because of the major practical difficulties in implementing this standard in some circumstances, the IASB should carry out discussions with the relevant preparers in order for a sensible and pragmatic solution to be obtained.

Materiality

The Committee notes that there is nothing in the draft standard stating whether or not it is intended to apply to immaterial items. We also note that the final version of the "Preface to International Accounting Standards", published in May 2002 by the IASB, removed the reference to materiality that had been included in the preceding ED. The Committee believes that this deletion was not appropriate and needs to be re-addressed somewhere by the IASB. We are likely to continue to raise this matter in relation to each new proposed standard issued by the IASB until it is satisfactorily addressed.

If there are any matters arising from this letter you would like to discuss, please do not hesitate to contact Paul Ginman (Chairman of the working party – 020 7413 5100) or Danielle Stewart (020 7731 6163).

Yours faithfully

A handwritten signature in black ink, appearing to read 'Danielle Stewart', with a stylized flourish at the end.

Danielle Stewart
Chairman, LSCA Technical Committee

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?

We agree with the circumstances when the IFRS should apply.

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 – 14 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?

As set out in our letter, we do not believe it will be possible for some companies to comply with the proposed IFRS in the case of IAS 39. The IASB therefore need to consider the introduction of some transitional provisions for IAS 39 as set out in the main body of our letter. With the exception of the difficulty with the implementation of IAS 39 we agree with the proposed exemptions.

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?

We think that the requirements of paragraph 31 are excessive. We do not believe that the additional burden in complying with (a)(i) can be justified. In addition the requirements of (c) appear to single out an individual standard unnecessarily.

In addition, we do not understand what is required in paragraph 32 in relation to cash flow statements for example is it the change from cash to cash equivalents (where made) or the changes in headings? The standard either needs to specify what is required or the sentence should be deleted and reliance based on the reconciliation required in paragraph 31.

Question 4

Do you have any other comments on the Exposure Draft?

In addition to the points set out in the main body of our letter we have the following comments:

- a) The ED does not make it very clear that an entity has a choice of changing its accounts as if it had always followed IAS, or to use the exemptions in the ED in full. We suggest this is emphasised in the introduction.
- b) We are confused by the exemption for subsidiaries in paragraph 5 and not sure that it is required. The subsidiaries' own accounts can be differentiated from those used for consolidation without any problem. The same result would appear to be obtained by relying on paragraph 13.

We believe that paragraph 5 (b) should not refer to unanimous agreement from minority interests, but instead the requisite consent required by law from minority interests.

- c) As stated above, we believe that, in the case of companies that will need to prepare opening IFRS balance sheets as at 1 January 2003, the practical difficulties of requiring IAS 39 to be implemented before the final standard is issued need to be addressed. In addition, the requirements in appendix C should be reworded to be clearer. Paragraph C3 (a) appears to mean that the opening IFRS balance sheet should be obtained by restating a closing old GAAP balance sheet before any change has been made to old GAAP hedge accounting. In many cases, old GAAP hedge accounting may not have involved the recognition of a derivative used for hedging that had no initial cost. This derivative may or may not qualify for hedge accounting under IAS 39, but it needs to be recognised at fair value in the opening balance sheet before consideration is given to whether it no longer qualifies as a hedge, or is a fair value or cash flow hedge. Presumably the first step in this conversion is to recognise all derivatives and other financial assets and liabilities in accordance with IAS 39 before consideration is given to whether hedge accounting is available under IAS 39 for any of the old GAAP hedges. It would be helpful if this were made explicit. In addition the introduction to C3 implies that the existing hedging documentation will be deemed to meet the new criteria, whereas paragraphs C3(b)(iii) and (c)(ii) make it clear that this is not the case.

The Board should review the drafting and contents of this very confusing Appendix to ensure that the requirements relating to this complex area of accounting are as understandable and unambiguous as possible.

- d) Paragraph 23 provides limited exemption from the need to recalculate the exchange differences on the net investment in a foreign enterprise. Many UK companies have not kept track of translation differences relating to net investments in foreign operations that they have written off to reserves. If it is not possible to determine the cumulative exchange difference under IAS 21, entities are permitted to deem the cumulative exchange difference under their existing GAAP, if any, as the IFRS cumulative exchange difference. We presume the "if any" is meant to provide relief to those companies that are not

required to maintain cumulative records of these numbers and that therefore, for these companies, the result will be zero.

- e) No guidance is given regarding the treatment of acquired associates and joint ventures. In particular, an exemption, similar to that given for business combinations, should be applied to fair values. There is a further issue in that hindsight will have to be applied to a judgement area as entities will have to go back and reconsider whether in fact an investment qualified as an associate or a joint venture.
- f) In paragraph 20(b)(i) there is a need to clarify that any intangible-related adjustment to goodwill should be treated in the same way as the original goodwill – i.e. be taken to reserves if that is where the original goodwill is sitting.
- g) Paragraph 7 should be redrafted to clarify that early adoption is permitted of a standard issued but not yet mandatory as at the reporting date.
- h) Paragraph 20 (b) states that there are 2 adjustments. However there are 3 as negative goodwill would not be recognised.
- i) As stated in our letter, Appendix B paragraphs (a) and (e) should be included in the standard and Example 4 moved to the implementation guidance.
- j) We are unclear as to what is meant in paragraph 2(b) in relation to financial statements that have been made available to an external user. Could this be to just one user? In addition this would imply that shareholders would not be given the additional disclosures proposed in this draft standard, although they would not previously have received IFRS compliant financial statements.