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10 November 2002

Sir David Tweedie
Chair of the International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: *Exposure Draft ED 1 First-Time Application of International Financial Reporting Standards*

Dear Sir David:

The Global Financial Reporting Advocacy Committee (GFRAC) of the Association for Investment Management and Research (AIMR)¹ is pleased to respond to the International Accounting Standards Board (IASB) *Exposure Draft ED 1 First-Time Application of International Financial Reporting Standards* (IFRSs).

The GFRAC is a standing committee of AIMR charged with representing the views of investors to and maintaining a liaison with bodies that set financial accounting and reporting standards in a global context, particularly the IASB. The committee is also charged with responding to requests for comment from national standard setters and regulators on international financial reporting issues.

General Comments

Overall, we support strongly, and commend, the Board on its proposal for first-time application of IFRSs. We firmly believe that the proposed presentation and disclosure requirements are necessary and provide meaningful information about a company's first-time adoption of IFRS. Such disclosure will be especially critical when several thousand companies, which are listed with the European Commission, will adopt IFRS on or before 2005. As a result, many users of financial statements will have their first exposure to financial statements prepared in accordance with IFRS. Therefore, those users will need numeric reconciliations accompanied by narrative explanations, which itemize the differences between the *previous GAAP*² and the first-time application of IFRSs for (1) beginning equity balance, (2) profit and loss, and (3) cash flow activities that were reported under previous

¹With headquarters in Charlottesville, VA, and regional offices in Hong Kong and London, the Association for Investment Management and Research® is a non-profit professional organization of over 61,000 financial analysts, portfolio managers, and other investment professionals in 114 countries of which 48,800 are holders of the Chartered Financial Analyst® (CFA®) designation. AIMR's membership also includes 117 affiliated societies and chapters in 29 countries. AIMR is internationally renowned for its rigorous CFA curriculum and examination program, which had more than 100,000 candidates from 143 nations enrolled for the June 2002 exam.

²As defined in the ED – The basis of accounting that a first-time adopter used immediately before adopting IFRS as its basis of accounting for the first time.

GAAP. Such information will enable users to analyze and compare more accurately the performance and financial condition of a company, as well as between companies, for those periods reported in accordance with IFRSs.

The following are our responses to the Board's specific requests for comments.

Question 1

The proposed IFRS would apply when an entity first adopts International Financial Reporting Standards (IFRS) 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 concur with the Board's requirement that a company should have to comply with *each* of the IFRS at the reporting date for its first IFRS financial statements as well as make an explicit and unreserved statement that those financial statements are in compliance with IFRS. Additionally, we agree with, and support, the Board's conclusion that any attempt to distinguish IFRS-compliant aspects of a company's financial reporting would result in unnecessary complexity and possibly, accounting arbitrage. Therefore, we have some reservations about allowing any exemptions from this Standard, in regards to specific areas, when a company has determined that the costs to apply a certain IFRS exceed the benefits to users of financial statements. Our general concern is that exemptions, which allow alternative application other than IFRS, will make financial statements less comparable. We discuss this issue further in our comments to **Question 2** below.

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?

As mentioned above, we generally oppose exemptions from the application of certain IFRSs because such flexibility would result in less comparable financial statements. However, we understand, and agree reluctantly, that some exemptions may be needed because the data produced to recreate historical-cost carrying amounts would be arbitrary and meaningless, as well as costly to produce. Moreover, we support the Board's proposal to use fair value measurements in determining

the carrying amounts for identifiable assets and liabilities on the opening IFRS balance sheet. Also, we agree strongly that those fair values will reflect conditions that existed at the date of the adoption of IFRSs and any resulting changes in the carrying amount should flow through retained earnings (or another category of equity if applicable) rather than goodwill.

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 agree strongly that this IFRS should not provide exemptions from the presentation and disclosure requirements in other IFRS, including comparative information for all periods reported in the first IFRS financial statements. Moreover, we support strongly that a company should provide narrative explanations, as well as numeric reconciliations, about the differences from previously reported financial information prepared using another set of accounting standards other than IFRS.

We concur strongly with the Board's decision to require a reconciliation of beginning equity and net income as outlined in paragraph 31, as well as the narrative explanations required in paragraph 32 of the ED, as follows:

31. To comply with paragraph 30, an entity's first IFRS financial statements shall include:

- (a) reconciliations of the entity's equity reported under previous GAAP to its equity under IFRS for both of the following dates:
 - (i.) the date of transition to IFRS; and*
 - (ii.) the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP;**
- (b) a reconciliation of the profit or loss reported under previous GAAP for the latest period in the entity's most recent annual financial statements to its profit or loss under IFRSs for the same period; and*
- (c) if the entity recognized or reversed any impairment losses for the first time in preparing its opening IFRS balance sheet, the disclosures to IAS, 36 Impairment of Assets, would have required if the entity had recognized those impairment losses or reversals in the period beginning with the date of transition to IFRSs.*

32. The reconciliations required by paragraph 31(a) and (b) shall give sufficient detail to enable users to understand the material adjustments to the balance sheet and income statement and shall distinguish changes in accounting policies from changes in estimates and from the correction of errors. An entity shall also explain the material adjustments to the cash flow statement.

In addition to reconciling the beginning equity balance and the profit and loss reported using the previous GAAP, we believe a reconciliation of the previously reported cash flow statement is also needed. The cash flows from operations could change because certain costs might be either capitalized or expensed under IFRS but not under the previous GAAP used to prepare the cash flow statement. Such changes would cause cash flows from investing activities to be affected as well. Additionally, for cash flows prepared using the indirect method, the net income (starting point) and components of cash flow from, or used by, operations could vary due to changes in inventory valuations, changes in methods used to calculate depreciation or amortization expense, and changes in other asset or liability valuation methods. Finally, requiring a reconciliation should not result in significant cost if companies will have to *explain the material adjustments to the cash flow statement*, because they will have to do a reconciliation to derive these material adjustments.

We believe that these disclosures *must* be provided to make the transition more transparent between the financial statements prepared using previous GAAP and those financial statements prepared in accordance with IFRS. Users of financial statements need such disclosures to understand fully the effects of the first-time application of IFRSs and how to incorporate those effects into their financial analyses and models used to assess the performance and financial condition of a company. Therefore, reconciling items should represent gross amounts and should not reflect the netting of material items that result in an amount labeled as "Other". Users need to have disaggregated information, as well as narrative explanations, about items on the financial statements in order to understand trends and predict future cash flows.

Finally, we believe strongly that separate explanations are needed to distinguish between reconciling items that result from changes in accounting policies and those that result from changes in estimates or correction of errors. We prefer that the accounting policies be specifically identified through a reference to a particular IFRS. In addition, we would want the explanations about the changes in trends, resulting from the implementation of the IFRS delineated from the economic effect of business activities.

Question 4

Do you have any other comments on the Exposure Draft?

We have a general concern about the adoption and enforcement of IFRS by national regulators. A current and pending example, is the adoption of IFRS in 2005 by the European Commission (EC) and the impact on EC listed companies to comply with those IFRS adopted by the EC. Under this scenario, as well as other national adaptations of IFRS, the EC may at its discretion accept, or reject any given IFRS. As such, our understanding is that if EC chooses to reject a given IFRS, than EC listed companies may be able to make an explicit and unreserved statement, indicating that their financial statements have been prepared in accordance with IFRS. Instead, an EC listed company might make a statement that it is in compliance with EC generally accepted accounting standards

and/or provide narrative explanations about the differences between IFRS and EC GAAP used to prepare the financial statements. In addition, other jurisdictions may reject or modify IFRS.

Therefore, we support strongly the notion that companies should only be permitted to make statements that they are in compliance with IFRS when all applicable standards are used, without modifications, to prepare the financial statements. Variations in a global set of high quality standards, such as IFRS, will undermine the primary goal for such standards, which is to promote the efficient functioning of the world's capital markets.

Closing Remarks

The GFRAC appreciates the opportunity to comment on the IASB' proposed standard for the first-time application of International Financial Reporting Standards. If you have any questions or require further elaboration of our views, please do not hesitate to contact Georgene Palacky at 1.434.951.5334 or georgene.palacky@aimr.org.

Sincerely,

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Chair, Global Financial Reporting Advocacy Committee

Farhan Mahmood, CFA
Subcommittee Chair, First-time Application of IFRS

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