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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street, 1st floor
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Zurich, 4 October 2002

Comments on Exposure Draft ED 1: First-Time Application of IFRSs

Dear Sir David,

We welcome the opportunity to comment on the above Exposure Draft. Please find enclosed both our overall comments and our response to each question asked in the ED.

Yours sincerely,

Swiss Institute of Certified Accountants and Tax Consultants
Accounting and Auditing Practices Committee

Urs Moser

Philipp Hallauer

Overall comments

We agree that it is important to clarify how IFRSs should be applied for the first time. We appreciate the examples included and the discussion in the Implementation Guidance of the implication of the ED on specific IFRSs.

While we generally agree with the proposals of this ED we have two major concerns:

- ***We feel that the proposed definition of a first-time adopter will cause an undue burden and / or odd results for many companies that have applied IFRSs as their primary basis of accounting but may have complied with IFRSs except for one or two deviations, for example in the area of disclosure.*** We understand that this ED has been developed primarily to facilitate the conversion process in the European Union, which we fully support. However, we believe it does not properly address the situation of companies that introduced IFRSs as their primary basis of accounting a long time ago (when even SIC-8 had not yet been in place). We also refer to our comments on question 1.
- We realise that the Board is deviating from the way that International Accounting Standards used to be drafted and structured. Specifically:
 - We do not understand the logic behind the (limited) use of bold letter paragraphs in the ED. For instance, the exemptions do not include any bold letter paragraphs although they represent clear requirements rather than guidance; on the other hand, the introduction to the exemptions, included in paragraphs 13 and 14, does not clearly distinguish between principles and guidance.

We appreciate that the Board recently decided to continue to use bold text. Bold paragraphs are important to highlight the main principles and to distinguish between those principles and additional guidance. ***We strongly recommend that the former practice of starting off with a principle, to be followed by the guidance paragraphs, be maintained since it facilitates the reading of a Standard considerably.***

- There is a lot of repetition in the Appendices of principles covered in the Standard itself. The Appendices should illustrate the principles, not repeat what is already covered in the Standard.
- The Appendices, Implementation Guidance and Basis for Conclusions include principles, guidance and wording that in our opinion should be included in the Standard itself.

Comments on questions**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?

No, we do **not** agree.

We do **not** believe that the IASB should require an entity to have had an explicit and unreserved statement of compliance with IFRSs in order not to be treated as a first-time adopter. This will force entities to make first-time application adjustments although they may have applied IFRSs, except for one or a limited number of deviations, for a long period of time. ***Instead, the focus should be on whether or not an entity has previously applied IFRSs as its primary basis of accounting.***

We realise of course that it may be judgemental to decide how many and what kind of deviations from IFRSs may be accepted in order to still be able to conclude that an entity's primary basis of accounting is IFRSs. However, auditors have to make such judgements when deciding whether a clean, qualified or adverse audit opinion should be rendered. If an auditor comes to the conclusion that an adverse opinion should be rendered, the financial statements do not comply with IFRSs regardless of whether the entity claimed that or not, and the entity would have to apply this Standard in order to obtain a clean IFRS audit opinion. ***Accordingly, the auditors will have to verify whether an entity applies IFRSs as their primary basis of accounting or not.***

Many entities have adopted IFRSs as their primary basis of accounting, but some may not have complied with all the requirements of IFRSs and, accordingly have received a qualified opinion. Once such an entity decides to remove a specific deviation, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* should be applicable.

Please note that these comments are also related to our comment on the "Improvements" Exposure Draft, which was as follows: "There is a lack of guidance on cases where companies state that they 'comply with IFRS except for...'. We believe that an enterprise should still be able to refer to IFRSs in the statement of compliance when the audit opinion is qualified, provided that the qualification is also included in the statement of compliance."

The following examples illustrate the concerns with have with the current proposal:

Example A

Assume an entity did state in its previous financial statements that they complied with IFRSs except that segment results were not disclosed. It would presumably have received a qualified audit opinion for this deviation from IFRSs. Under the ED, this entity would be treated as a first-time adopter of IFRSs (paragraph 2 a iii). Assume further that the entity properly followed SIC-8 when adopting IFRSs.

The fact that this entity becomes a first-time adopter enables it not only to possibly charge an impairment loss to opening retained earnings, but also to recognise any actuarial gains and losses on pension obligations immediately with effect to opening retained earnings. The same treatment does not apply to an entity that claimed to be fully compliant with IFRSs although the auditors qualified their opinion for the same reason (paragraph 3 c).

This does not lead to comparable results.

Example B

Assume an entity did state in its previous financial statements that they complied with IFRSs except that segment results were not disclosed. It would presumably have received a qualified audit opinion for this deviation from IFRSs. Under the ED, this entity would be treated as a first-time adopter of IFRSs. Assume further that the entity adopted IFRSs before SIC-8 came into effect and that its first-time application did not fully comply with SIC-8.

Such an entity would be forced to choose either to apply the exemptions or to redo the first-time application based on the guidance of SIC-8. Please note that many Swiss entities introduced IAS long before SIC-8 was known. It would be very cumbersome to analyse to what extent the first-time application complied with SIC-8. It is further not clear to what extent the current exemption from a full retrospective application when the adjustment cannot be reasonably determined (SIC-8, paragraph 3 b) could still be applied under the new Standard.

We feel that this Standard has been drafted primarily to facilitate the first-time application of IFRSs in the European Union (which we fully support) without, however, taking into account the situation in countries where IFRSs have been applied for many years.

Comments on specific paragraphs relating to question 1

Given our view to focus on the primary basis of accounting instead of on an explicit and unreserved statement of compliance with IFRSs, we hereby give the following more specific comments on paragraphs 2-5:

Paragraph 2

- We agree with paragraphs 2 a)-c) with the exception of paragraph 2 a) iii), which should be deleted based on the discussion above.
- We think it would be useful to clarify in a new sub bullet point that entities that at some point in time did apply IFRSs as their primary basis of accounting, but later converted to US or another national GAAP, should be treated as first-time adopters of IFRSs if/when they change back to IFRSs (unless they have continued to prepare "parallel" IFRS financial statements). Some companies in Europe that converted to US GAAP from IFRSs will have to convert back to IFRSs.

Paragraph 3

- The current sub bullet point c in our opinion proves that the definition of a first-time adopter is wrong: Under the current proposal an entity would not qualify as a first-time adopter if its previous financial statements contain an explicit and unreserved statement of compliance with IFRS although the audit report is qualified. Another entity that was honest enough to repeat the auditors' qualification in its statement of compliance would, however, qualify as a first-time adopter.
- Based on the discussion above, we propose to add another sub bullet point clarifying that an entity that presented financial statements with an explicit but reserved statement of compliance with IFRSs is not a first-time adopter, provided that the auditors rendered a qualified but not adverse opinion.

Paragraph 5

- We believe that it is a risky approach to automatically exempt from first-time application a subsidiary that previously reported under IFRSs to its parent company, and the parent company prepared IFRS consolidated financial statements (paragraph 5 a). Any eventual deviations from IFRSs in a subsidiary's financial statements may not be material at consolidated level, but may well be material at the level of its stand-alone financial statements. We believe that a subsidiary that prepares, for the first time, stand-alone financial statements in accordance with IFRSs, should have to apply this Standard.
- As a result, we also propose that paragraph 5 b) be deleted. It should in any case not be up to the shareholders to decide upon whether an entity qualifies as a first-time adopter or not.

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?

Accounting policies

We agree that an entity applying the exemptions should 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.

We also agree that entities not applying the exemptions should apply the IFRSs that were effective in each period, and may therefore have to consider superseded versions if later versions required prospective application.

Exemptions

In general, we agree with the proposed exemptions; however, we propose the following modifications:

- We do **not** agree that property, plant and equipment should be valued at values determined in accordance with a price index (paragraph 17). We do not believe that additional measurement bases "broadly" (how to define broadly?) comparable to cost or fair value should be introduced, that are not otherwise allowed under IFRSs.
- We do **not** agree that event-driven fair value measurement should be used as described in the ED (paragraph 19). We believe that event-driven fair value measurement should be limited to situations where the original cost basis cannot be determined without undue cost or effort.
- We do **not** agree that goodwill should be tested for impairment regardless of whether there is an indication of impairment or not (paragraph 20 b ii). We believe that IAS 36 *Impairment of Assets* should apply which requires an impairment test when there is a specific indication of impairment.
- We agree that IAS 39 *Financial Instruments: Recognition and Measurement* should be applied prospectively in respect of hedge accounting. However, we do **not** agree with the proposal relating to financial instruments designated as hedges under previous GAAP, set out in Appendix C, paragraph C3, a) and b): In our opinion the Standard should clarify that it is up to the entity to decide whether any derivative should be designated, at the date of transition, as a hedge (if the IAS 39 criteria are met) or not. The minimum requirement is to recognise all derivatives on the opening balance sheet.

We further believe that hedge accounting should always be applied prospectively and that this should apply to **all** entities introducing IFRSs, regardless of whether they apply the exemptions or not (see paragraph 13).

Comments on specific paragraphs relating to question 2**Paragraph 8**

- The last paragraph in the example box states: "If a new IFRS is not yet mandatory for periods ending on or before 31 December 2005 but permits early application, entity A is permitted, but not required, to apply that IFRS in its first IFRS financial statements". We recommend this statement be made more general and included in a separate paragraph as it constitutes specific guidance on paragraph 7, and as such should not be "hidden" in an example.

Paragraph 9

- For clarification reasons and to be consistent with paragraph 7, add "...and also in its opening IFRS balance sheet" at the end of the paragraph.

Paragraph 12

- We believe that it should be clarified that deferred tax be recognised on all adjustments. We therefore recommend the last sentence to be drafted as follows: "An entity shall recognise those adjustments directly in equity, taking into account any deferred tax effects."

Paragraph 20

- We believe that the Standard should also clarify whether or not a goodwill that was previously charged to equity (Appendix B - Example 4) should be "recycled" to the income statement upon the sale of the respective entity. Since cumulative translation differences must be recognised in the income statement upon the disposal of a subsidiary, the same should apply, in our opinion, to goodwill previously recognised in equity.
- The proposed Standard does not address how an entity accounts for the first-time consolidation of a subsidiary that was previously excluded from consolidation due to a different activity. Would the first-time adopter have to apply IAS 22 retrospectively in this case, would it be acceptable to adopt the subsidiary's carrying amounts, and any resulting goodwill, as deemed cost as at the date of first-time application, or to account for the subsidiary as if it had been acquired as of the date of first-time application?

Paragraph 23

- We propose that the Standard clarify that cumulative translation differences, as determined at the date of first-time application, continue to be subject to the "recycling" requirement of IAS 21.37 upon the disposal of a foreign entity.

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 do **not** agree with all the proposed disclosure requirements.

- We do **not** believe it is justified to require a reconciliation of equity at the end of the latest period presented in the most recent annual and interim financial statements under previous GAAP (paragraph 31 a ii and 37 b).

The current proposal would require an entity, in its first half year report under IFRSs, to disclose 3 detailed equity and 2 profit reconciliations, a clear information overload. We believe the equity reconciliation between previous GAAP and IFRSs should be disclosed in detail as of the date of transition because that is the date on which the IFRS adjustments are actually recognised. In addition, the profit reconciliation should be limited to the respective comparative period presented. Accordingly, in an entity's first half year report under IFRSs, disclosure should be limited to a reconciliation of equity as of the opening balance sheet date of the comparative period, and of profit for the comparative half year.

- We recommend including disclosure requirements for those (as we think would be rare) cases where event-driven fair value measurement has become deemed cost for assets and liabilities.
- We agree that historical summary tables should not be restated (paragraph 36). However, we do **not** agree with the requirement to disclose the nature and the main adjustments that would make the data comply with IFRSs. Such summary tables are normally presented outside the financial statements and therefore should not be included in the scope of this IFRS. A general description of the main adjustments would require a detailed analysis of the financial situation and performance of each year, the costs of which would clearly outweigh the benefits.