



31 October 2002

International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XII  
United Kingdom

Dear Sirs,

**MAZARS RESPONSE ON ED 1 FIRST-TIME APPLICATION OF  
INTERNATIONAL FINANCIAL REPORTING STANDARDS**

The Mazars Group has offices in 55 countries world-wide. European members of the Mazars Group have formed an IAS taskforce which regularly meets to discuss technical issues as a group. The European members' taskforce, which currently includes technical representatives from Mazars' offices in France, the United Kingdom, the Netherlands, Belgium, Italy, Spain and Germany, has recently considered the ED 1 First-time Application of International Financial Reporting Standards and wishes to make the following response to the International Accounting Standards Board on behalf of Mazars' offices throughout the world. Our comments include the specific issues raised by the Board in the Exposure Draft together with a number of other significant matters we have included under question 4 below.

**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, we agree that the inclusion of an explicit and unreserved statement of compliance with all IFRSs is an appropriate way for an entity to indicate that it is adopting IFRSs for the first time.

We however believe that paragraphs 2(a) (iii) and 3 (c) should be matched and hence modified. In our view wherever a company has made a statement of compliance with IFRS, with exception or not, IFRS being its primary basis of accounting, and its auditors have issued an audit report on the compliance with IFRS, whether qualified or not, then it should not be regarded as first-time adopter.

We also recommend that paragraph 5 of the Standard (which deals with first-time adopter subsidiaries of which accounts have been consolidated in compliance with IFRS) be clarified in order to explicitly reflect paragraph BC63. We would also suggest that this paragraph be presented as a specific exemption to paragraph 7 (what it really is) instead of being presented as a scope item.

Furthermore we consider that this exception should be applied wherever “no objection has been received – within a span of time prior to the issuance of financial statements and after the question has been raised – from the minority shareholders”. We indeed consider that in many cases it will be impracticable to obtain the unanimous agreement of the minority as currently proposed by paragraph 5(a).

## 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?*

We support the general concept of full retrospective application of all IFRSs when an entity prepares its first IFRS financial statements.

We agree that where entities opt to use the limited exemptions in Paragraphs 16 –24, they should not be able to cherry pick which ones to apply. Thus we concur with the approach of using all or none of the exemptions as proposed in paragraph 14. We consider that this will aid comparability during this transitional phase to international standards.

However, we consider that the inclusion of certain exemptions to this general concept is an absolute necessity as otherwise transition will not only result in “undue cost or effort” (as referred to in BC 13) for certain entities, but also provide users of financial statements with information lacking in both reliability and comparability. All supplementary exemptions recommended below are intended to allow companies to concentrate their efforts on preparing high-quality IFRS compliant prospective information without impairing the reliability and comparability of the information presented.

## 1- Construction contracts

As we understand, first-time adopters are required to apply the percentage of completion method as of the date of transition to IFRS. This suggests that their accounts reflects the estimation of outcome at three different dates: transition date, end of comparative year and reporting date.

We recommend that first-time adopters that apply the percentage of completion method for the first time at the reporting date be allowed to reflect the last estimation of outcome as of the reporting date throughout the periods presented. In our view such an implementation procedure makes the implementation process much easier without impairing the reliability of the information presented.

## 2- Tangible assets

One of our main concerns regarding tangible assets relies in the very strict and limited alternative offered between either a full retrospective IFRS compliant cost basis or fair value as deemed cost. In our opinion this strict alternative does not optimise the reliability and comparability of the information presented.

### *a) use of fair value as deemed cost*

IAS 16 paragraphs 30 and 31 do not provide enough guidance as to how to determine fair value of plant and equipment, when there is no observable market. Because of technological evolutions, the depreciated replacement cost does not embody a reliable measurement, since equipment strictly equivalent or comparable to the equipment in use is no longer available. Also, because industrial equipment is most often very specific to the entity, there is no observable replacement market.

We therefore call for a more detailed and more relevant implementation guidance.

### *b) Previous cost bases provide with more reliable information and involve less effort*

The more complex and sophisticated plant and equipment grow, the more deluding the use of fair value appears. Moreover determining fair value for tangible assets may involve undue cost or effort. We therefore support retaining previous cost bases in the critic situations detailed below.

#### - Borrowing costs

In accordance with their national standards, entities may have reported borrowing costs as part of the acquisition cost of some tangible assets but not all of them. Whether the entity retains the benchmark or the alternative treatment authorised in IAS 23, restating cost information is necessary. This however involves cumbersome efforts. Retaining fair value as deemed cost also.

We therefore suggest that IAS 23 be applied prospectively, in accordance with transition provisions included in that statement. Wherever the treatment of borrowing costs is the sole different component in the cost of acquisition of tangible assets, we indeed believe that previous cost bases are the most relevant.

- Implementing the component approach

Where the component approach involves a change in accounting policies, implementing such an approach is one of the major changes that the conversion to IFRS implies. It therefore constitutes, in our opinion, an “undue cost or effort” issue.

We have experienced in some conversion projects that there is indeed a huge, tremendous effort involved in:

- splitting all existing tangible assets into components,
- determining a sound deemed cost for each of those (whether fair value is used).

We therefore recommend that first-time adopters be exempted from implementing the component approach retrospectively, as of the transition date.

Moreover, where the issue is most critical, companies used to account for a provision for major overhauls and repairs which does not comply with IAS 37 requirements.

Those provisions cannot be derecognised unless the component approach is implemented.

For those businesses involved in this issue, we recommend, as a transition provision, that companies be allowed to present their previously reported provision for major overhauls and repairs for a span of time to be defined. During that time, new tangible assets would be accounted for in full compliance with IAS 16 component approach and no additional provision expense would be accrued. At the end of the derogatory delay or at any point in time when the company would be ready to do so (remaining tangible assets would have been appropriately split into components), appropriate disclosures and reconciliation of data would be provided.

We are also concerned with provisions regarding decommissioning and site restoration costs.

We do not consider relevant trying to reflect what the estimate of decommissioning and site restoration costs would have been at the time of acquisition. We therefore recommend that the estimate of those costs at the reporting date be used not only as a basis for the recognition of a provision under IAS 37 requirements but also as valuation of the related asset component. The difference between the provision

amount and the asset valuation would reflect depreciation of the asset and the unwinding of the discount because of the passage of time (cf BC 66). We however suggest that the discount rate be the rate as of the acquisition date, discount rates of prior periods being available.

We note that the ED needs clarification on this issue, IG 10 and BC 66 being inconsistent. We recommend that IG 10 be rewritten on the basis of the above suggested implementation method.

### **3- Financial assets and liabilities**

In this area also, we believe there is a need for an exemption. According to national standards, transaction costs associated with financial assets and liabilities may have been expensed as incurred.

Digging into previous accounting periods cannot be ensured exhaustive (some of the information requested may be over ten years old) and constitutes a cumbersome effort. We therefore recommend that effective interest rates for existing financial assets and liabilities do not reflect those transaction costs that have been expensed in previous years.

### **4- Hedging**

We do not support the prospective treatment as proposed. Implementing IAS 39 as to hedging may involve great changes in company practices and information systems.

In our opinion prohibiting retrospective designation to avoid cherry-picking is not a sensible decision, since companies may enter market transactions in order to obtain the desired effect on their accounts. It should indeed be recalled that many national standards do not require derivative recognition.

We recommend that IAS 39 be implemented, with appropriate documentation and effectiveness as of the date of transition. Companies will hence concentrate on preparing high-quality information in relation to hedging on a prospective basis. That is, in our opinion, how users of financial statements will best be served.

### **5- IAS 39: other issues**

We firmly believe that exemptions are needed in relation to IAS 39 "Financial Instruments: Recognition and measurement". Whilst we acknowledge for certain entities that IAS 39 should not cause major problems other than those mentioned above, we do not believe this is the case for all entities (e.g. Banks, insurance companies and energy companies to name a but a few). We consider that too many uncertainties still exist in this area.

### 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 with the disclosures required as part of FTA implementation. We however would favour exemptions to provide all IFRS disclosures on a comparative basis. Even with a planned approach in place it may not be possible to collect the information needed on a comparative basis. This, in our opinion, mainly (but not only) arises in some areas where financial instruments and employee benefits are concerned.

Although we have not yet gathered a detailed list of the exemptions that are desirable, we would be happy to provide it at the Board's request.

Also we recommend the Board to specify what comparative information should be presented, in case a business combination is to be reported in the year of adoption of IFRS.

### Question 4

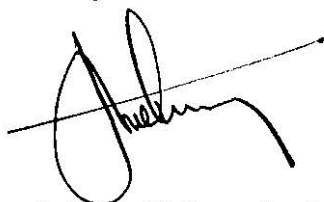
*Do you have any other comments on the Exposure Draft?*

1. We consider there is a need for a paragraph supplementary to paragraph 7 clarifying what accounting policies are to be complied with from the transition date on. That paragraph should state the following:
  - accounting policies mandatory at the reporting date have to be applied,
  - accounting policies issued at the reporting date, not yet mandatory but where early adoption is encouraged, may be applied,
  - accounting policies issued but not yet effective at the reporting date must not be applied.
2. We note that no exemption has been included in relation to past acquisitions of associates and joint ventures. We believe that acquisitions of associates and joint ventures should be included in the scope of the exemption for business combinations.
3. We consider that there is considerable room for improvement in the clarity of the text used between paragraphs 7 to 14 (inclusive). First-time adoption requirements essentially means full retrospective application of all IFRSs or retrospective application using the exemptions (without cherry picking) to the extent that they are applicable. One clear paragraph making this point would be preferable.

4. We do not believe that the three document approach adopted by the IASB on this occasion is the best way to present Exposure Drafts. We would prefer just one document.
5. We believe that the mention that this standard need not apply to immaterial items should be included in the final standard.

If there are any matters arising from this letter that you would like to discuss, please do not hesitate to contact either Steven Brice (Mazars' IAS Taskforce member – UK ) on 0207 220 3231 or Françoise Flores (Mazars' IAS Taskforce member – France) on +33 (1) 49 9760 00

Yours faithfully,



Signed on behalf of Mazars by Jean-Louis LEBRUN