

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

In Prague, 24th October 2002

cy: 86/2002

Re: Comment Letter on IASB ED of First-time Application of International Financial Reporting Standards

The Chamber of Auditors of the Czech Republic welcomes the opportunity to submit its comments to the International Accounting Standards Board regarding the Exposure Draft of proposed IFRS *First-time Application of International Financial Reporting Standards*.

The above mentioned IFRS will become one of the most important regulation from the Czech accounting entities point of view because the entire majority of them will fall under the scope of the above standard. Therefore we consider it necessary to get the clear and explicit guidance and rules to move towards the application of IFRSs. Our comments result from the discussion of the issues related to the application of the standard in the Czech Republic environment.

Q1

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 do not understand the reasons for the distinction made between the accounting entities that are mentioned in paragraphs 2(b) and 2(c). The entity that prepared financial statements under IFRSs for internal use only (para 2(b)) is in our opinion the specific example of the entity that did not present its financial statements at all (and there is no need to distinguish what standards were the basis of accounting). On the other hand, is it appropriate to regard the entity as a first-time adopter also if the financial statements for previous periods prepared under IFRSs for internal use only were audited without any qualification?

Regardless of the above the wording of the paragraph 2(b) is not clear in our opinion. What period should the financial statements prepared under IFRSs for internal use relate to (there is no reference to the most recent previous financial statements or previous periods)?

We do not agree with the principle set out in the paragraph 3(c). In our opinion it is necessary to consider the type and the reasons of the qualification made by auditors. In the specific cases, e.g. if the auditor issued an adverse opinion on the compliance with IFRSs regarding the financial statements related for previous period (where an explicit and unreserved statement of compliance with IFRSs was contained for the first time), the entity should be considered a first-time adopter.

Revaluation by reference to general/specific price index (para 17)

We do not consider this concept as useful. We believe that revaluation by reference to general/specific price index may result in significantly different outcomes as compared to either costs or fair value and we do not believe that such kind of valuation should be permitted in IFRS. In addition to that, the paragraph 17 neither specifies the usage of indexes in detail nor provides further guidance which may lead to inconsistent application of different kinds of indexes.

In connection with the issues mentioned above, we would recommend the following:

We believe that from the options mentioned in paragraph 16 and 19, only the fair value at the date of transition may be permitted. This would make the treatment consistent for all companies that are not able to determine the historical costs of PPE. We would, therefore, recommend to delete paragraph 19. We recommend also to delete paragraph 17. We believe that paragraph 16 is sufficient suitable alternative for those entities that are not able to determine the costs of PPE.

In addition to that, we believe that if the company decides to adopt exemption described in paragraph 16, it should be forced to measure and record the fair value for the entire class of property, plant and equipment and, subsequently, measure those assets in accordance with the allowed alternative treatment set out in IAS 16 (i.e. fair value – depreciation – impairment).

b) Business Combinations

We would like to draw the IASB's attention to the fact that under some local GAAPs (i.e. also in the Czech Republic), the concept of business combination including mergers was or has been significantly different from IFRS concept as described in IAS 22.

Therefore, suggested concept of overtaking local GAAP carrying amounts of assets, liabilities and goodwill (broadly speaking) from local GAAP for the purpose of opening IFRS balance sheet seems not to be appropriate. The Board should consider the following facts:

- In some local GAAPs, neither assets nor liabilities have been measured using their fair value at the time of business combination. The carrying value of those items may be determined by local policies far different from IFRS.
- Under local GAAPs, the assets and liabilities might have been revalued to fair value because of event such as merger in the past whilst under IFRS no such revaluation would be required as of that date. Therefore, this may cause the similar problem regarding determination of consistent costs/carrying value of PPE as for individual financial statements as described in paragraph 16.
- The goodwill recognized according to local GAAP may very often not to be a goodwill that would be recognized under IFRS rules.

On the other hand, we see the complications that would result from reconstruction of the effect of business combinations retrospectively, as if it would have always been made under IFRS rules.

We suggest the Board to consider:

1. Whether the fair value concept could be used also for measuring property, plant and equipment as at the date of transition for the purpose of business combination.

Q2

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 principle set out in paragraph 7. Application of the accounting policies complying with each IFRS effective at the reporting date throughout all periods presented in entity's first IFRS financial statements should significantly facilitate the transition to a new basis of accounting.

We also agree the first-time adopters should be permitted to use the limited exemptions from the above principle set out in paragraphs 16 to 24. What we do not understand is the wording of the third and fourth sentence of the paragraph 13. In our opinion it should be much more transparent for any users of the first IFRS financial statements if the general principle to apply the latest version of IFRSs set out in paragraph 7 and 8 is used (regardless of the permitted exemptions are used by the entity or not) and only the items specified in paragraph 14 should be treated different way according to the provisions set out in paragraphs 16 to 24. In our opinion it should be also in line with the requirement of enhanced comparability of the first IFRS financial statements. However, the current wording of the paragraph 13 forces entities to use the exemptions as the only way to apply the general principle set out in paragraph 7 ("If an entity does not use the exemptions,....., the entity shall apply the IFRSs that were effective in each period and may, therefore, need to consider superseded versions of IFRSs if later versions required prospective application.") and we really do not understand the reasons why the application of the general rule should be determined by using of the exemptions.

We do not agree with the wording of the first sentence of the paragraph 14. We do not believe that an entity should necessarily use all of the exemptions mentioned in paragraphs 16 to 24. An entity should be allowed to choose any of the exemptions and not to use all of them because those exemptions are not of the same nature. In our opinion if an entity applies only some of those exemptions it would not distort the view, consistency and comparability of the presented IFRS financial statements.

In addition, we feel that the paragraphs 16 to 24 may lead to certain significant inconsistencies and issues. Let us mention the main ones:

a) Determination of value of Property, plant and equipment

Fair values at different points of time

The paragraph 16 allows the entities to use the fair value of PPE at the date of transition as their deemed cost at that date. Paragraph 19 permits the companies to use the fair value of PPE determined as of certain date in the past as a result of privatisation/IPO as deemed cost at that date for subsequent accounting under IFRS.

We see significant inconsistency in this treatment. Whilst the entity which was privatised e.g. 10 years ago will determine the fair value as at this date and apply subsequently 10-years depreciation, the other entity may determine the fair value of the similar asset as of the date of transition. This may provide significantly different results for assets of similar nature and age.

2. Whether the goodwill should be treated at all. We feel that similarly to negative goodwill – IASB should consider to propose not to recognize any goodwill as at the date of transition. That would eliminate any differences in recognition/measurement of goodwill under the local GAAPs.

Q3

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 all of the disclosures and consider them appropriate.

In addition, we would like to suggest the Board to require the disclosure of the entity's opening balance sheet in its first IFRS financial statements. We do not believe it is appropriate to require the disclosure of comparative information in paragraph 29 and disclosure of reconciliation of equity in paragraph 31(a)(ii) without presentation of opening balance sheet itself. We, therefore, propose to amend the last sentence of paragraph 10 as follows:

"This IFRS requires an entity to present its opening IFRS balance sheet in its first IFRS financial statements".

Q4

Do you have any other comments on the Exposure Draft?

We would like to make the following additional comments:

1. Paragraph 13

We believe that the concept of exemptions where the cost of complying with the requirements would exceed the benefits to users of financial statements is very broad and subjective and should be strongly limited in its use. We feel that whilst the accounting entity may be able to determine the costs of complying with the requirements, it generally would be difficult for it to quantify what are the benefits to users of financial statements. Therefore, we feel the practical difficulties in applying such concept. We also believe that this concept may be misused and may cause any inconsistencies between the financial statements the impact of which may be enormous. We suggest that the compliance with the IFRS in all aspects should be emphasized and the exemptions based on excessive costs explicitly limited to specific, exceptional circumstances as described further in IFRS.

2. Paragraph 2(c) – Entity that did not present financial statements

There are mentioned the entities that did not present their financial statements for previous periods in paragraph 2(c) of the Exposure Draft. It is not clear if the wording "did not present" means that the financial statements have not been made widely available or have not been presented at least to regulators or banks or anything else. Because this is the key issue to properly classify an entity as a first-time adopter we suggest IASB to clarify this provision.

3. Paragraph 25

We do not agree with the concept and wording of paragraph 25. The estimates made under the local GAAPs should be obviously rather different from those estimates that would be made applying the substance over form/true and fair view concepts. Nevertheless, it is fairly incorrect to declare those estimates as errors. The wording of paragraph provide an entity

only with two possibilities – either to continue the estimates made under the previous GAAP or to declare those estimates as error and to replace them by the new estimates made in accordance with IFRSs. The text in the brackets (“after adjustments to reflect any difference in accounting policies”) is not clear and creates a lot of questions regarding proper application of this provision.

Instead of the current wording included in the Exposure Draft, we believe that IFRS should require the revision of all currently used estimates as at the date of transition. It should further clarify the proper accounting treatment of any resulting changes in the following way:

- a) If the prior estimate has represented true estimate under the conditions and circumstances applicable at the time when the estimate was made, the effect of a change should be applied currently and prospectively from the date of transition.
- b) If the prior policy was based on the local GAAP requirements without taking into the account the true and fair view, the effect of the change relating to the previous periods should be recognized directly in equity as of the date of transition.

4. Appendix A

We suggest to combine the Appendix A with the Glossary and to attach the definitions directly to the list of defined terms in Appendix A (as it has been done in Glossary).

We hope you'll find our suggestions helpful and we would be pleased to discuss any aspect of this letter you may wish.

Yours sincerely,



Petr Kříž
President of CACR