

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

Düsseldorf, 31.10.2002
526/520

Dear Sir David,

Re: Exposure Draft ED 1: First-time Application of International Financial Reporting Standards

We appreciate the opportunity to comment on the aforementioned Exposure Draft and would like to submit our comments as follows:

General remarks

As stated in the introduction the objective of the Exposure Draft is to ensure that an entity's first IFRS financial statements contain high quality financial information that is transparent for users and comparable over all periods presented, provide a suitable starting point for the entity's subsequent accounting and can be generated at justifiable cost. In our opinion the primary objective of the standard must be world-wide comparability of IFRS financial statements of different companies.

From a conceptual point of view SIC-8 provides the most appropriate rules for the first time application of IFRS since it requires that the financial statements should be prepared and presented as if they always had been prepared in accordance with the standards and interpretations effective for the period of first time application. In our understanding the Exposure Draft - which is rather unclear and difficult to understand in this respect - gives the enterprises a choice between at least two methods, i.e. to apply the SIC-8 approach or to apply a simplified approach including all of the exemptions which are applicable under paragraphs 16 – 24.

We accept that for practical reasons a retrospective application of IFRS should not be required, if in exceptional cases the amount of adjustment cannot be determined without undue cost or effort. However, the proposed set of rules gives the impression that the practicality of the first time application of IFRS and cost considerations take precedence over the comparability of financial statements. Furthermore it would be very helpful in practice if a definition of the new expression "undue cost or effort" used in paragraphs 14, 16, 23 and 35 were given.

If it proves true that the Board will finalise the new standard in the second quarter of 2003 we believe that the proposed effective date for periods beginning on or after 1 January 2003 (paragraph 38) is too early for first-time adopters, especially those with quarterly or semi-annual reporting under IAS 34. We recommend that the Board consider an effective date for periods beginning on or after 1 July 2003, with early adoption encouraged.

Comments on the questions set out in the Exposure Draft

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 that it is appropriate to determine the first time of application of IFRS as being the first time the financial statements include an explicit and unreserved statement of compliance with all IFRS.

According to the criteria in paragraph 2 an entity should be regarded as a first-time adopter if it previously prepared financial statements under IFRS for internal use only, without making them available to its owners or 'other external users'. It should be clarified, that the term 'other external users' does not include an entity's regulators.

Paragraph 3 (c) accurately states that an entity should not be treated as a first time adopter if it presented financial statements in the previous year that contained an explicit and unreserved statement of compliance with IFRS, but the auditors qualified their audit report on those financial statements. The Exposure Draft does not mention the case where the auditors expressed an adverse opinion on the entity's IFRS financial statements in the previous year. In our opinion in this case an entity should

be regarded as a first time adopter in the current year. We recommend that this be clarified.

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?

Paragraph 7 requires that an entity shall use in its opening IFRS balance sheet and throughout all periods presented in its first IFRS financial statements those uniform accounting policies that comply with each IFRS effective at the reporting date for its first IFRS financial statements. However, in contrast, the third sentence of paragraph 13 indicates that the principle in paragraph 7 requires that the entity 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. From a conceptual perspective we would prefer the latter approach of fully retrospective application of IFRS (see SIC-8), because it contributes to the comparability between enterprises which apply IFRS for the first time and enterprises which apply IFRS for a longer time. However, for practical reasons compliance with all the IFRS effective at the reporting date should be permitted.

If an entity wishes to take advantage of the exemptions in paragraphs 16 – 24, according to paragraph 14 it shall use them all. With regard to the quality of the financial statements, i.e. the degree of compliance with IFRS, it would be preferable if an enterprise were permitted to choose only those exemptions which are necessary for reasons of practicality and not to have to use all of them. We acknowledge that the proposed requirement attempts to enhance the comparability between first time adopters and prevents “cherry picking”. However, since some of the exemptions permit the continuation of carrying amounts determined under local GAAP we doubt whether comparability between first time adopters actually can be achieved.

Apart from these general reservations it has to be noted that the standard does not clearly distinguish between the two types of exemptions, i.e. those exemptions, that apply only in case of “undue cost or effort” and other exemptions, that are mandatory if the entity wants to apply paragraphs 14 - 24.

The Exposure Draft states in paragraph 20 (a) that ‘immediately following the business combination’, the carrying amount under previous GAAP of assets and liabilities

acquired in that business combination shall be their deemed cost under IFRSs at that date if IFRSs require a cost-based measurement of those assets and liabilities at a later date. The Exposure Draft does not address the issue of how to apply the exemptions if the first time consolidation has not been carried out 'immediately following the business combination' but at a later date without retrospective determination of the costs of individual assets, liabilities and goodwill. For example under the rules of the 7th EU Directive, many parent companies are not required to draw up consolidated financial statements until the size of the business combination exceeds certain thresholds. If the thresholds have been exceeded for the second financial year consolidated financial statements may be prepared on the basis of the book values and fair values of the assets and liabilities as at the date of first time consolidation. We recommend a clarification, whether in those cases the carrying amounts under previous GAAP of assets and liabilities can be their deemed cost according to paragraph 20.

The proposed exemptions set out in paragraphs 16 to 18 are designed to avoid the restatement of amounts when this is not possible without undue cost or effort. For example under German GAAP the application of the completed contract method is mandatory for construction contracts; the percentage of completion method as described in IAS 11 'Construction Contracts' is not compatible with German GAAP. Therefore, it is presumed that many German entities do not have the necessary information to restate the amounts related to construction contracts at the date of transition. We suggest adding a corresponding exemption to the final standard.

Furthermore, in Germany legal requirements prohibit entities from capitalising development cost or cost incurred from internally generated intangible assets. Hence, those entities may not have previously collected the data of such projects. We agree in general with the IASB's view limiting the exemptions to specific transactions and to use "undue cost or effort" as an underlying principle. However we feel that this principle should be applied consistently. Accordingly, it would also appear reasonable that those intangibles should be dealt with in the same way as property plant and equipment. Therefore, we recommend that fair value measurement as deemed cost at the date of transition should be permitted for intangible assets other than goodwill if fair value is determinable by reference to a strictly defined active market. In this context it should be considered to amend paragraph 16 similarly in order to clarify that fair value can only be accepted if a strictly defined active market exists.

We are unsure why paragraph 23 just relates to "...a net investment in a foreign operation". Some people understood that paragraph 23 refers to all translation adjustments but the literal wording does not support this. If the limitation is done on pur-

pose we do not understand the conceptual reason. If all translation differences are meant, this should be so expressed.

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?

In principle we agree to the proposed disclosure requirements.

Paragraph 32 requires a detailed explanation of the reconciliation of the entity's equity reported under previous GAAP to its equity under IFRS (paragraph 31 (a)) and the reconciliation of the profit or loss reported under previous GAAP to its profit or loss under IFRS (paragraph 31 (b)). We suggest including more guidance - possibly by way of an example. For instance, opening IFRS balances could be presented in the notes of the first IFRS financial statement as a three column analysis containing for each line item the opening balance figures before adjustments, all material adjustments as well as the opening balance figures after the adjustments.

In our view the explanation of material adjustments to the balance sheet and the income statement should be disclosed. The cash flow statement is usually derived from the income statement and changes in the balance sheet compared to the prior year. Therefore, it does not seem to be reasonable to require the explanation of the material adjustments to the cash flow statement as paragraph 32 stipulates.

We understand that the disclosure requirements of the Exposure Draft relate only to an entity's first financial statements prepared under IFRS. The application of the exemptions in paragraphs 16 – 24, e.g. the use of fair value as deemed cost for some items of property, plant and equipment, affects the comparability between the financial statements of the entity concerned and the financial statements of other entities, which did not apply the exemptions, even in future periods. Therefore, at least the fact that the entity has applied the exemptions from a retrospective application of IFRS in a prior period should be disclosed as long as a material reduction in comparability remains.

Question 4

Do you have any other comments on the Exposure Draft?

- (1) Appendix B Business Combinations B1(e) states that an entity shall not recognise negative goodwill in its opening IFRS balance sheet. We suggest including this rule in the standard and not in an Appendix. According to example 4, an entity that has acquired a subsidiary and has booked goodwill against reserves under its previous GAAP should not make any adjustment when converting to IFRS. However, the example is silent as to what happens if the subsidiary is re-sold subsequently. If it were to be resold for the original acquisition price the group will present a gain equal to the amount of goodwill previously charged to reserves. To avoid this distortion only the profit in excess of goodwill previously booked against reserves should be taken to income.
- (2) Paragraph 25 states that an entity's estimates under IFRSs at the date of transition to IFRSs shall be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. According to paragraph 26 an entity may need to make estimates under IFRSs at the date of transition that were not required at that date under previous GAAP. To comply with IAS 10 those estimates shall not reflect conditions that arose after the date of transition.

However, it is pointed out in the application guidance (IG2) that paragraphs 25 – 27 of the draft standard require some modifications to the principles in IAS 10. As we understand the examples (case 1 and case 2), estimates made under previous GAAP shall be revised only if there is objective evidence that they were in error. Revisions based on adjusting events shall be reported as events of the period in which the entity makes the revisions.

We do not agree with the proposed different treatment of adjusting events depending on whether they relate to estimates which have been made already under previous GAAP or estimates that have to be made for the first time according to the requirements of IFRS. In our opinion, all adjusting events should be taken into consideration according to IAS 10.7, i.e. at the date of transition to IFRS.

Yours sincerely



Norbert Breker
Technical Director Accounting and Auditing