



International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH

31 October 2002

Dear Sirs

**First-time Application of International Financial Reporting Standards (ED1)**

Having reviewed the above exposure draft, published in July this year, the comments of IAFEI are set out in this response.

We welcome the initiative being undertaken by the Board in proposing to introduce this standard and fully support the objective thereof as set out in the first and third paragraphs of the introduction to the exposure draft. In addition we can see this objective being reflected in the Board's conclusions, such as those concerning comparability (paragraph BC16), measurement (paragraph BC23), use of fair values (paragraph BC33) and employee benefits (paragraph BC50). We are, therefore, in broad agreement with the Board's proposals with regard to first-time application. However, you will see from our responses below that we do have concerns about some of the details in the draft standard.

We believe that it is important for the Board to recognise the impact of the 2005 deadline on companies within the European Union and minimise, as far as possible, significant changes to IFRSs in the period prior to the deadline. In order to comply with the changeover to IFRSs, companies will need to undertake a major exercise and produce voluminous information for end 2003 and during 2004 and 2005, while the transition will also have a major impact on internal as well as external reporting. We would hope that the Board will bear in mind when considering IFRS changes that one of this standard's objectives refers to costs not exceeding the benefits to users.

In reviewing the proposed standard, we note that there is no reference to international standards not being intended to apply to immaterial items. This was previously included in a standard opening paragraph to all previous IASs. We have also noted the comment in the July 2002 edition of Insight regarding the removal of the similar reference in the Preface to IFRSs subsequent to the exposure of the draft version for comment. We believe that such a reference to materiality is a useful addition to accounting standards and efficient reporting, while without it preparers will undertake costly and time consuming work which yields no commensurate benefit to users. We

would therefore strongly urge the Board to consider reintroducing an opening paragraph on this subject in all its standards.

### **Response to the Board's specific questions**

**Q1** We agree that it is appropriate to regard the first-time application of IFRSs as being the first time that an entity includes an explicit and unreserved statement of compliance with all IFRSs in its financial statements.

**Q2** We find the wording used in paragraphs 7 and 13 extremely confusing. These state that an entity should only apply the general principle set out in paragraph 7 if it uses the exemptions permitted by paragraphs 14 to 24. If the entity does not use the exemptions, then paragraph 7 does not apply and the entity should apply the IFRSs effective in each period. Either the general principle as worded in paragraph 7 is not the general principle or paragraph 13 should be altered so that companies which do not use the exemptions follow paragraph 7. We believe the latter is more appropriate and would suggest that these paragraphs should be revised. We would expect a standard to require the application of a general principle subject to the use of any permitted exemptions.

We agree that the exemptions set out in paragraphs 16 to 24 are appropriate. However we are concerned with the requirement in paragraph 14 which states that, if an entity uses these exemptions, it has to use all applicable exemptions. Such an "all or nothing" approach does not seem right, given the different bases for the types of adjustment set out in paragraph 14 and the criteria used to justify those areas included in paragraph 14 (a). This approach would presumably mean, for example, if an entity could obtain appropriate IFRS figures for property, plant and equipment but not for goodwill or employee benefits, it would be forced to use all the exemptions and therefore less appropriate figures for property, plant and equipment. We believe that removing this requirement would not greatly affect comparability and indeed by minimising exemptions should enhance comparability, but understand that it could raise a concern about "cherry picking". However there has to be some reliance on management and auditors to make judgements if we are to have standards that are based on principles and provide the most meaningful information at a reasonable cost.

Paragraph 20 (b) (ii) introduces a requirement to test goodwill for impairment, regardless of whether there is any indication of impairment. Whilst we appreciate the concern over double counting noted in paragraph BC45 of the Basis for Conclusions, we believe that this requirement need only be applied in certain circumstances. We would suggest that such impairment testing is limited to instances where the net assets of an acquired entity are increased significantly by the IFRS changes as it is only in such situations that the possibility of materially overstating the related goodwill could arise. Furthermore it should be made clear that any impairment is treated in accordance with paragraph 12.

**Q3** We do not believe that any further disclosures are necessary. We feel that paragraph 32 is appropriately worded as further disclosure for each entity will reflect the material adjustments they have made, which may affect different lines of the financial statements for different entities. With regard to the requirement in paragraph 31 (b), we would recommend revision to the existing wording to make it

clear that the necessary reconciliation should be in respect of the net profit or loss for the period i.e. the profit or loss after tax and minorities.

**Q4** We would make the following additional comments on the exposure draft:

We agree with the concept of “undue cost or effort”. This seems a reasonable and pragmatic approach by the IASB given the size of the task facing all first time appliers of IFRSs, particularly those faced with the 2005 deadline in Europe.

We agree with the approach taken in paragraphs 36 and BC97 on historical summaries given the consequences for preparers of requiring full restatement. However we are concerned with the implications of the second sentence of paragraph 29. For example, for a company in Europe, with a US listing, adopting IFRSs in 2005, this would require full data for end 2002 as well as 2003 annual results. Given the size of the IFRS conversion exercise and the continuing moving target, this imposes far too high a burden on the companies affected. Any requirement on comparative data should be limited to just the preceding year.

We agree with the approach in paragraph BC41 of not requiring the review of past business combinations to identify assets and/or liabilities not recognised under previous GAAP. However the reference in paragraph 21 to “The same applies to any adjustment resulting from the recognition of an asset or liability not recognised under previous GAAP.....” seems to be contradictory with paragraph BC41.

Following on from the prior point, in respect of IAS39 we would ask the Board to consider an exemption for derecognition transactions in line with paragraph 172 (a) of IAS39. Without this companies will need to track back over a number of years to try to identify possible transactions which might have been treated differently under IFRSs.

We were somewhat surprised to find that the standard’s objective was included at the beginning of the introduction to the exposure draft. Given its importance to preparers and users alike, we believe that it should be incorporated into the standard itself.

We note that in paragraph B1 (e) of appendix B to the standard it states that an entity should not recognise negative goodwill in its opening balance sheet. The related footnote explains that this reflects a proposal to be included in a future exposure draft on business combinations. Inclusion of such a requirement would seem to be prejudging the outcome of proposals yet to be issued for consultation, thus ignoring the usual policy of due process.

On the subject of hyperinflation, we note the Board’s conclusion set out in paragraph BC71 and would again express our concern over the Board’s narrow approach in this area. As we said in our comments on the proposed revision of IAS21 as part of the improvements project, we believe the Board’s assumption, that there is one right and precise answer to deal with high inflationary economies, is misguided. The use of a hard currency to deal with a high inflationary environment is a fairly common, alternative approach to the problem. Companies will not only be forced into potentially confusing and costly exercises going forward with no internal or external benefit, but they will also have to revisit their historical numbers with similar

consequences. The application of this approach without exception is an unnecessary and unjustified restriction which will cause problems and cost for preparers (and thus is at odds with the exposure draft's objective).

In summary we support, in broad terms, the Board's approach to first-time application of IFRSs and agree with the draft standard's objective. However as set out above, we believe there are a number of areas that should be reconsidered by the Board in finalising the resultant standard.

We hope that you find our comments useful and thank you for giving us the opportunity to comment on the Board's proposals.

Yours faithfully

A handwritten signature in black ink, appearing to read 'D.C. POTTER', enclosed within a large, irregular oval shape.

D C POTTER  
Chairman, C.I.A.S.