

# ISDA

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31 October 2002

## **ED1 - First-time application of International Financial Reporting Standards**

Dear Sir David

The International Swaps and Derivatives Association (ISDA) appreciates the opportunity to comment on Exposure Draft 1 – First-time application of International Financial Reporting Standards.

Our members represent leading participants in the privately negotiated derivatives industry and include most of the world's major financial institutions, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities.

Our responses to the questions posed by the IASB in Exposure Draft 1 are contained in Appendix 1.

There are two key points that ISDA raises in this response. Firstly, ISDA supports full retrospective application of IFRS effective at the reporting date for all areas where an exemption is not applied. Secondly, ISDA believes that exemptions should be applied based on a principle of undue cost and effort. In this regard ISDA believes that areas

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of derecognition and consolidation of SPEs should be added to the list of exemptions subject to this principle, as these are two areas where the effort and cost is likely to be excessive for certain entities.

We have made every effort to be complete and clear in our response, we would be pleased to discuss our comments with the Board or staff. To arrange this please contact either Sue Harding on 020 7888 2664 or Ed Duncan on 020 7330 3574 or at the above address.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Sue D. Harding", with a stylized, flowing script.

Sue Harding  
Chair, ISDA European Accounting Committee

A handwritten signature in black ink, appearing to read "Ed A. Duncan", with a stylized, flowing script and a long horizontal flourish underneath.

Ed A. Duncan  
Assistant Director of European Policy  
ISDA.

## Appendix 1 – IASB's specific questions on ED 1

### 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?

ISDA agrees with the proposal.

### 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?

ISDA generally agrees that an entity should apply IFRS effective at the reporting date for its first IFRS financial statements and believes that exceptions will be needed in specific, limited situations.

#### **General principle for exceptions**

The list of exemptions set out in ED1 does not constitute a stated principle for exceptions to the retrospective application of IFRS effective at the reporting date. Instead, ED1 appears to present an assessment of areas where the Board believes retrospective application of IFRS would impose undue cost and effort. ISDA believes that exceptions to retrospective application of all IFRSs should be based on a sound, explicitly stated principle. ISDA believes that the principle should be based on where the costs or effort would be undue, and should be phrased so as to make it clear that exceptions are expected to be made only in very limited circumstances (see *Undue Cost or Effort* below). The topics listed as exemptions in the ED could then be modified to serve as examples of the application of the stated principle. Additionally, all exceptions to the retrospective application of IFRSs should be required to be fully disclosed in the financial statements.

### ***Undue cost or effort***

As drafted, the concept of undue cost or effort does not seem to provide for circumstances where information has been lost and cannot be recreated, or where the entity has no legal right to obtain the necessary data. An example of the latter would be where the entity is required to consolidate an SPE of which it is not a shareholder and has no contractual or other ability to obtain the relevant information. ISDA believes that to address these circumstances the Board should either expand the concept of undue cost or effort or provide an additional exemption.

### ***Specific exemptions***

In the event that the IASB chooses to adopt the proposed approach of listing exemptions, the following additional comments need to be taken into account:

#### ***Superseded standards***

ISDA is concerned that paragraph 13 of the ED is unclear, but appears (in contradiction to paragraph 7) to state that where an entity chooses not to apply the exemptions, then the entity must apply the standards that were in place in each earlier period. Given that the IASB has sought to improve International Accounting Standards over time, ISDA believes that presenting information under superseded standards cannot lead to high quality information. While paragraph 13 needs to be redrafted to make the Board's intentions clear, ISDA generally supports full retrospective application of IFRS effective at the reporting date for all areas where an exemption is not applied.

However, ISDA also agrees that in the example given in BC62 it would be appropriate to apply superseded IFRS (In this example a subsidiary applies IFRS for the first time, having previously prepared its accounts under national GAAP and information for its parent to comply with IFRS). In this case, a good argument can be made not to require the entity to go to the effort to revise its accounts so as to differ from the treatment applied by the parent. However, paragraph 13 appears to be wider in its scope and hence is inappropriate, as drafted.

#### ***"All or none" use of exemptions***

In paragraph 14 it is unclear as to what is meant by "it shall use them all, to the extent that they are applicable". If this means that where an entity uses one exception it must use all of them to the extent that they are relevant to the entity's business, ISDA disagrees with the ED. ISDA believes that the determination of whether to apply the exemptions should be made on a case-by-case basis, taking into account the specific provisions of the exemptions and the transactions being considered. ISDA believes that a requirement to apply all, rather than selected, exemptions could mean that useful information that could have been provided will not be.

ISDA believes that where an entity has the information to apply IFRSs retrospectively in a meaningful manner then it should not be prohibited from doing so. As a result, ISDA does not believe it is appropriate to require the exemption in

paragraph 20 to apply to all business combinations. For example, for more recent transactions, information may be available to apply IAS 22 retrospectively, which may result in a more appropriate representation.

*Partial availability of information*

ISDA does not believe ED1 is clear on how to assess undue cost or effort. For example whether the assessment is carried out at transaction level, at some higher level of categories of transactions, or for entities within the consolidated group, etc. ISDA believes that ED1 is unclear as to how an entity should deal with a situation where some, but not all, information is available without undue cost or effort. ISDA seeks clarification as to whether in this situation a partial exemption should be applied relating to the information that is not available, and an adjustment made for information that is available. Alternatively, does the Board intend that exemptions are “all or nothing”? ISDA believes that where an entity has the information to make an adjustment in a meaningful manner, then it should do so.

*Additional exemptions*

ISDA believes that there are other areas, not listed as one of the proposed exemptions, where the concept of ‘undue cost or effort’ (as modified above) should be applied. ISDA believes that specific exemptions should be introduced in the following areas:

*i. Derecognition*

Consistent with our comment letter on the Exposure Draft relating to IAS 39, we believe that whilst it may be theoretically sound to assess whether assets previously derecognised should now be treated differently, it will not be possible to examine every transaction undertaken in previous years to make such an assessment. Further, in light of the complex proposals in the Exposure Draft this is almost certainly an area where there would be undue cost and effort and imperfect information. Therefore, ISDA believes that the results of applying this approach in all circumstances will be misleading in some cases.

ISDA believes that it is extremely relevant that no entity has ever had to apply retrospectively the IAS 39 derecognition criteria, since there was no retrospective application when IAS 39 was first introduced. Hence, the costs and effort, and the practicality, of applying the standard retrospectively are, as yet, unknown.

*ii. Accounting for Special Purpose Entities (SPEs)*

Similar to the rationale set out above relating to derecognition, ISDA believes that the undue cost and effort in getting information relating to SPEs previously not required to be consolidated under the relevant GAAP, and in some cases the lack of entitlement to the information, means that this

is an area where an exemption from retrospectives application should be allowed, where these difficulties can be demonstrated.

**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?

ISDA agrees with most of the proposed presentation and disclosure requirements. However, ISDA believes that paragraph 32 requires additional explanation, perhaps in the form of examples, to make clear that the reconciliation should separately identify components of adjustment amounts. For example, adjustment of amounts before tax and minority interests and the effect of those adjustments on deferred tax and minority interests should be shown independently. Additionally, adjustments related to business combinations should be shown separately so that the amounts related to individual line items on the balance sheet and income statement are clear.

ISDA believes where an exemption is applied, that fact should be disclosed in subsequent years until it can be demonstrated that the effect is probably not material. For instance, if property, plant and equipment is included on first time application on a basis other than original cost, this fact should be disclosed along with the date of first time application, until the level of depreciation is such that the difference in net carrying value due to the use of the different basis is probably immaterial, whatever the basis used. Continued disclosure will help identify cases where accounts of different entities may not be directly comparable.

**Question 4**

Do you have any other comments on the Exposure Draft?

ISDA has no further comments.