

180 Strand
London WC2 1BL
United Kingdom

Tel: National +44 20 7438 3000
Direct Telephone: +44 20 7438 2511
Direct Fax: +44 20 7438 2821
www.deloitte.co.uk
www.iasplus.com



31 October 2002

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir David,

Exposure Draft - ED 1 First-Time Application of International Financial Reporting Standards

Deloitte Touche Tohmatsu is pleased to comment on the International Accounting Standards Board's (IASB's) Exposure Draft – ED 1 *First-Time Application of International Financial Reporting Standards* (IFRS). Our objective in developing this letter is to provide constructive feedback to assist the IASB in developing standards of the highest possible quality. The Exposure Draft contains four specific questions. Our responses to those questions are set out in the appendix to this letter.

We commend the Board for paying particular attention to the need for a new International Financial Reporting Standard dealing with the special case of first-time application of IFRS. We believe there is an urgent need for providing a timely, high quality Standard on first-time application as well as allowing time to communicate recommended implementation strategies and processes to those parties affected by this major change—notably, the approximately 7,000 companies required by Regulation of the European Union to apply IFRS by 2005.

We also support the IASB's proposal to provide a universal solution for any entity or jurisdiction adopting IFRS for the first time, regardless of whether adoption occurs in 2005 in Europe or at a different time in another region of the world. As a result, we understand and accept that seeking comparability with entities already applying IAS/IFRS is of secondary priority and importance. We support the IASB's conclusion that comparability of an entity's financial statements over time is the primary objective, while seeking comparability between entities applying IFRS at a given date shall be considered to the greatest extent possible.

We support the notion that an entity, when adopting IFRS as its basis of accounting, shall make an explicit and unreserved statement of compliance with IFRS in its first IFRS financial statements. We believe such a statement is needed to ensure a high level of quality and transparency in financial reporting today.

Overall, we are supportive of the opening balance sheet approach as outlined by the IASB in the Exposure Draft. We believe the approach addresses the practical problems of applying the previous requirements under SIC-8, First-Time Application of IASs as the Primary Basis

of Accounting, and the IASB has accomplished its objective of ensuring that an entity's first IFRS financial statements contain high quality information.

Nonetheless, our review of the Exposure Draft identified a number of issues that arise from applying the different options and exemptions under the opening balance sheet approach that we believe should be addressed by the IASB. In some cases, we were able to identify potential alternative solutions for the Board's consideration. Those issues and alternative solutions are identified in the appendix to this letter.

We thank you for the opportunity to provide our comments. If you have any questions concerning our comments, please contact Ken Wild in London at +44 (20) 74382511.

Sincerely,

Deloitte Touche Tohmatsu



DELOITTE TOUCHE TOHMATSU

APPENDIX
Comments of Deloitte Touche Tohmatsu on
Exposure Draft 1 on
First-time Application of
International Financial Reporting Standards

Question 1

The proposed IFRS would apply when an entity first adopts 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 support the notion that an entity, when adopting IFRS as its basis of accounting, shall make an explicit and unreserved statement of compliance with IFRS in its financial statements. However, we suggest including the wording in paragraphs 11 and 14 of IAS 1 (or at a minimum a reference to those paragraphs) to clarify the meaning of the explicit and unreserved statement of compliance. In making an explicit and unreserved statement of compliance, we believe it is important to require use of specific terminology such as “in compliance with IFRS”. We believe the Standard should be clear that in cases where an entity has included in its previous GAAP financial statements terminology indicating that such financial statements are “consistent with”, “based on” or “substantially similar to” IFRS, that entity is not considered to have previously adopted IFRS.

Financial Statements Prepared under IFRS for Internal Use

Additionally, we believe that if an entity’s previous financial statements included an explicit and unreserved statement of compliance with IFRS but such financial statements have not been widely distributed or made generally available to the entity’s owners or other external users, then these financial statements should be considered to have been for internal use. Consequently, the entity would not be considered to have adopted IFRS and, therefore, would be subject to the requirements of the Exposure Draft.

To reflect that comment, we suggest that the wording for paragraph 2(b) be modified as follows: “prepared its most recent previous financial statements under IFRS for internal use only, without widely distributing or making them generally available to the entity’s owners or other external users”.

Reference to Audit Reports, when the Underlying Criterion is Management’s Assertion of Compliance with IFRS

To clarify the scope of the Standard, we recommend that paragraph 3(c) be deleted and replaced with a new paragraph 4 that includes wording from the last sentence of paragraph BC10. We do not believe the Standard should make reference to audit reports, as management’s assertion of compliance with IFRS is the underlying criterion that an entity should consider in determining whether it is within the scope of the Standard, or not. We suggest that the new paragraph 4 be worded as follows: “An entity is not considered a first-time adopter when it presented financial statements in the previous year that contained an

explicit and unreserved statement of compliance with IFRS, and, consequently, it shall correct as errors any material undisclosed departures from the requirements of IFRS under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.”

First-Time Adoption for Subsidiaries, when Previous Reporting to the Parent has been Prepared Using IFRS

We believe paragraph 5 should be modified to exclude from the scope of the Standard only those subsidiaries with no publicly listed shares or debt if the parent’s previous consolidated financial statements contained an explicit and unreserved statement of compliance with IFRS as those subsidiaries would be considered to have adopted IFRS when their parent did. We believe, however, that those subsidiaries shall comply with the disclosure requirements in paragraphs 29-37, when presenting their IFRS financial statements on a stand-alone basis for the first time. We also support narrative disclosure of changes in accounting policies from previous GAAP financial statements to IFRS.

We believe subsidiaries with publicly listed shares or debt require additional consideration. If such subsidiaries have not previously issued separate financial statements with an explicit and unreserved statement of compliance with IFRS, then we believe they should be within the scope of the Standard (that is, treated as first-time adopters), irrespective of the parent’s reporting.

We would also recommend deleting the reference to minority interests in paragraph 5(b). However, if the Board decides to retain paragraph 5(b), we would suggest that the exemption also be available to all controlled subsidiaries, not only wholly owned. We would also support another change to this paragraph, if retained, stating that as long as there is no opposition from (rather than unanimous agreement by) the minority interests, the subsidiary is not treated as a first-time adopter.

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 exemptions appropriate? Should the Board amend any exemptions or create any further exemptions (paragraphs BC11-BC89)? If so, why?

Overall, we support the opening balance sheet approach outlined in the Exposure Draft. The Exposure Draft provides practical solutions to issues encountered under the requirements of SIC-8. However, we have identified certain areas where the Exposure Draft could be enhanced to better ensure comparability over time within a first-time adopter's first IFRS financial statements and comparability between different entities applying IFRS at the same time.

General Approach

We believe that it is important to minimise the choices an entity has in how it first adopts IFRS. We note that the provision in paragraph 13 effectively allowing an entity a choice for a SIC-8 approach is inconsistent with the general principle stated in paragraph 7 of the Exposure Draft. We do not believe that first-time adoption with consideration of superseded versions of IFRS provides high-quality information. We believe that the information would be more transparent for users and comparable for all periods presented if the general principle in paragraph 7 is applied when not using the exemptions.

As a result, we suggest an alternative approach (in three steps) under which the option in paragraph 13 is eliminated and, instead, an entity is permitted to apply some or all of the exceptions in paragraphs 16-24 on a case-by-case basis, subject to the following two restrictions:

IAS 39 Financial Instruments: Recognition and Measurement

We agree there are practical issues where accounting measurements rely on designation by management. This is no more evident than with hedge accounting under IAS 39. Therefore, we agree with the proposal in the Exposure Draft prohibiting retrospective designation (or retrospective reversal of a designation) of a hedging relationship. Accordingly, we believe this exception shall be mandatory in all circumstances.

IAS 19 Employee Benefits

We agree that measurement of an entity's net defined benefit plan asset or liability at the date of transition to IFRS shall apply the requirements in paragraph 154 of IAS 19. Therefore, we agree with the proposal in the Exposure Draft to reset to zero any unrecognised actuarial gains or losses at the date of transition. Accordingly, we believe this exception shall be mandatory in all circumstances.

Grandfathering of Business Combinations Entered into Before the Date of Transition

We support the proposal in paragraph 20 to provide an exemption for business combinations recognised under previous GAAP before the date of transition. We recognise that the treatment of goodwill that was immediately deducted from equity under previous GAAP is addressed in Example 4 of Appendix B. However, we believe that the current guidance is unclear as to whether this amount will affect the reported gain or loss upon subsequent disposal (or closure of the business) of the acquired business or a segment of the acquired business. We also believe that guidance is needed on whether to perform impairment reviews of goodwill previously deducted from equity. We recognise that these issues are broader than the scope of this Exposure Draft, but believe that they are important issues that the Board should consider as part of the business combinations project.

Accounting for Previous Acquisitions of Investments in Associates and Joint Ventures

We suggest that the IASB clarify that the grandfathering of business combinations and goodwill (mentioned above) also applies to accounting for acquisitions of investments in associates and joint ventures recognised under previous GAAP before the date of transition.

Accounting for Negative Goodwill – Now and in Future

We disagree with the wording used in IASB's proposal that an entity shall not recognise negative goodwill in its opening IFRS balance sheet. Footnote 3 of Appendix B, Business Combinations states "The statement that an entity shall not recognise negative goodwill in its opening IFRS balance sheet reflects a proposal in phase 1 of the IASB's project on business combinations, for which the IASB plans to publish an exposure draft later this year." We believe that the treatment of negative goodwill should follow the guidance that is in effect when the final Standard on first-time application is issued. In terms of due process, we consider that the wording of the IASB's proposal on negative goodwill in this Exposure Draft implies that this issue has been finally decided, which may be viewed as pre-empting the discussions to be held and submissions to be sent in on the IASB's project on business combinations.

Expenditures on Intangible Assets Previously Expensed

We believe that the wording of paragraphs IG36-IG41 could be improved. Paragraph IG40 states that intangible assets shall be recognised in the opening balance sheet, if the recognition requirements of IAS 38 were met at the date of transition. However, paragraph IG38 (including reference to IAS 38, paragraph 59) states that expenditure on an intangible item previously expensed shall not be recognised as part of the cost of an intangible asset at a later date. We believe it is not clear how those paragraphs would apply if, for example, the conditions in IAS 38, paragraph 45 were met at a previous point in time before the date of transition, but the entity had an accounting policy under previous GAAP of expensing all development costs. We recommend that the IASB clarify whether previously expensed intangible asset can be capitalised in any circumstances, and if so, under which circumstances. We also believe that it will be helpful, if guidance is provided on whether intangible assets acquired in a business combination (including IPR&D) are treated the same as those acquired separately.

Classification of Lease Contracts in Business Combinations

At the date of transition, a lessee or lessor shall classify leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease. It is not clear whether lease classification is grandfathered under paragraph 20(a) in the Exposure Draft or reclassified under paragraph IG11 based on the circumstances existing at inception (IAS 17, paragraph 10). We suggest that the IASB clarify that in Appendix B, Business Combinations, paragraph B1(a) and the implementation guidance in paragraphs IG11-IG13 on lease classification if lease contracts are acquired in a business combination.

Employee Benefits and Fresh-start Accounting to Past Service Costs

For defined benefit obligations, we support the method of “fresh-start” accounting for actuarial gains and losses in paragraph 22. Our interpretation of this paragraph is that any past service costs for benefits not yet vested are deducted from the defined benefit obligation under IAS 19 (see also paragraph 154 of IAS 19 dealing with the transitional liability for defined benefit plans). Those past service costs shall be recognised in later periods. However, the implementation guidance (paragraph IG15) states that the transitional provisions in IAS 19 do not apply to an entity’s opening IFRS balance sheet. We believe that this is an inconsistency, which should be eliminated by clarifying the implementation guidance on accounting for past service costs in the opening IFRS balance sheet.

Accounting for Previously Derecognised Financial Instruments

We believe that entities should be required to restate their financial statements for financial assets or financial liabilities or parts thereof that were derecognised but would not have been derecognised under IAS 39. However, we note that there may be significant difficulties in retrospectively estimating the fair value of retained components of financial assets or financial liabilities (for example servicing assets and liabilities) otherwise derecognised under previous GAAP. Therefore, we believe that the IASB should acknowledge the cost and effort necessary to estimate the fair value of retained components of financial instruments and provide examples to assist entities with implementation of the transition provisions.

Split Accounting for Compound Instruments

The Exposure Draft requires an entity to bifurcate the debt and equity components of a financial instrument based on the information available at issue or contract date, and classify the components either as financial liabilities or equity instruments in accordance with the substance of the contractual arrangements. We believe that full retrospective application of “split accounting” would be burdensome and suggest that an entity only be required to apply split accounting for financial instruments that are issued or outstanding at or subsequent to the date of transition.

Hedge Effectiveness Testing at Date of Transition

Appendix C, paragraph C3 (c) (ii) states that an entity shall classify deferred gains and losses as a separate component of equity to the extent that the hedged transaction is still expected to occur and the other criteria in paragraph 142 of IAS 39 are met. Further, the designation and documentation shall be assessed at the date of transition, not before. We suggest that guidance on whether any portion of gain or loss resulting from ineffectiveness shall be recognised in opening equity at the date of transition or in net profit or loss immediately after the date of transition, is needed. We believe examples would be helpful, for example, based on IAS 39 *Implementation Guidance* Q&A 172-2.

Decommissioning and Site Restoration Costs

Paragraph IG10 provides guidance on recognising decommissioning and site restoration costs. This paragraph indicates that differences arise between the carrying amount of the provision and the amount included in the carrying amount of the asset due to, for example, depreciation and impairment losses. However, in the Basis for Conclusions, paragraph BC66, states that these differences also are caused by the unwinding of the discount because of the passage of time. We believe this inconsistency should be eliminated and clarified. We also suggest that this issue be addressed in the improvements to IAS 16 *Property, Plant and Equipment*.

Accounting for Income Tax Consequences Related to Adjustments on Date of Transition

We do not believe that the Exposure Draft adequately discusses or addresses the tax implications of first-time application. We propose that implementation guidance be developed to clarify the application of IAS 12, Income Taxes, in the context of the transition adjustments.

Use of the Term “Estimates” or “Assumptions and Inputs”

We believe that the use of the word “estimates” in paragraphs 25-27 is not the right term and might confuse readers of the final Standard, if retained. Instead of stating that an entity’s estimates under IFRS shall be consistent with its original estimates, we believe it is more accurate to say that the assumptions or inputs that an entity uses to arrive at estimates under IFRS at the date of transition shall be consistent with the original assumptions or inputs. We note that paragraph 86 of the IASB Framework uses the term “estimate” broadly and is generally applied to arrive at cost or value. Thus a literal reading of paragraph 25 of the Exposure Draft would imply that an entity should not change the previously assigned cost or value of an item when applying IFRS for the first time.

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 believe the proposed presentation and disclosure requirements are appropriate. However, we suggest the IASB address the following three issues in the final Standard:

More Detailed Narrative Information to be Encouraged in the MD&A

Paragraph BC94 states that some narrative information is required about other adjustments, as well as about adjustments to the cash flow statement. We support this type of narrative information in the financial statements, but also believe that the IASB should consider encouraging entities to provide more detailed narrative and descriptive information outside the financial statements, for example in the MD&A.

Statement of whether Historical Summaries are Restated or Not

The Exposure Draft does not require historical summaries to comply with IFRS. However, in any financial statements containing such summaries, an entity shall disclose the nature of the main adjustments that would make the data comply with IFRS, but is not required to disclose quantitative information relating to those adjustments. While we support this proposal, we believe an entity should disclose whether the summaries have been restated or not.

Disclosure of Exemptions Applied

We believe that an entity should disclose in its first IFRS financial statements which of the optional exemptions it has applied in preparing its opening IFRS balance sheet.

Question 4

Do you have any other comments on the ED?

Use of the Term “Undue Cost or Effort”

As stated in our comment letter on the Exposure Draft of Proposed *Improvements to International Accounting Standards*, we do not support using the term “undue cost or effort” without reference to these situations being rare. We believe “undue” is subject to a wide range of interpretation and fails to recognise the importance of trend analysis to the user of financial statements. We encourage the Board to emphasise that it expects restatement in all but very rare circumstances. We propose wording (especially in paragraph 16) such as “In extremely rare circumstances, it may be impracticable...”

Use of “IFRS” and “IFRSs”

We suggest using “IFRS” throughout the Standard, on the basis that it is a collective acronym that can be used in both the singular and plural.

Transitional Provisions

Paragraph IG34 states that the transitional provisions in IAS 36 and IAS 37 do not apply to an entity’s opening IFRS balance sheet. That statement is redundant of paragraph 9 in the Exposure Draft, and therefore, should be deleted. Whether or not paragraph IG34 is retained, under the general principles of the opening balance sheet approach in paragraphs 11 and 12 of the Exposure Draft, we believe it is clear that any adjustments due to impairments or changes to provisions are recognised in opening equity rather than income. Some may view this approach to conflict with IAS 36, paragraph 59. Therefore, we would support the Board adding some explicit clarification about the consequences of not applying the transitional provisions in IAS 36 and IAS 37 for first-time adopters.

We have noted a possible contradiction between the transitional provisions in the Exposure Draft to Revised IAS 16, paragraph 66A, and the Exposure Draft on first time application. Although the Exposure Draft generally requires retrospective application (unless specific exemptions are applied), paragraph 66A of Exposure Draft of Revised IAS 16 is to be applied prospectively to exchanges of assets. We believe that the requirements should be the same under the two Standards.

Effective Date

We believe that paragraph 38 should be a bold-lettered paragraph.

Based on the project's timetable, we presume that the IFRS on first-time application will not be approved and available until 2003 at the earliest. Generally, we do not believe application prior to approval by the IASB should be allowed, however earlier application may be encouraged in the final Standard. Therefore, we would support either of the following approaches to effective date of the Standard:

Alternative 1: "An entity shall apply this IFRS if its first IFRS financial statements are for a period beginning on or after 1 January 2004 [or the date of publication of the Standard if different]. Earlier application is encouraged."

Alternative 2: "An entity shall apply this IFRS if its first financial statements are for a period ending on or after 31 December 2003 [or the date of publication of the Standard if different]".

We believe that either of those proposals will accommodate those entities required, or electing, to transition to IFRS for annual financial statements ending on or after the date of publication in 2003.