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Additional exemptions proposed for first-time adopters

In September 2008, the International Accounting Standards Board (IASB) published for public comment an Exposure Draft (ED) of proposed amendments to IFRS 1 **First-time Adoption of International Financial Reporting Standards** (IFRSs).

The additional exemptions proposed in the ED deal with oil and gas assets, assets used in operations subject to rate regulation, and arrangements containing leases. These are areas of particular interest in some jurisdictions (notably Canada) that are planning to adopt IFRSs in the near future.

The IASB has requested comments by 23 January 2009.

Deemed cost for oil and gas assets

The ED proposes that an entity that used the full cost method* for oil and gas assets under its previous GAAP may elect, at the date of transition to IFRSs:

- to measure its exploration and evaluation assets using amounts determined under previous GAAP; and
- to measure oil and gas assets in the development or production phases by allocating the amount determined under previous GAAP to the underlying assets on a pro rata basis using reserve volumes or reserve values as of the date of transition to IFRSs.

* Under full cost accounting, exploration and development costs for properties in development or in production are accounted for in cost centres that include all properties in a large geographical area. Very often, this area would represent a larger unit of account than would be permitted under IFRSs. The carrying amounts of assets under previous GAAP may include items that do not qualify for capitalisation under IFRSs (e.g. some overheads, costs incurred before legal rights to explore were granted, and unsuccessful exploration costs that have been included in the full cost pool).

Entities would also be required to test oil and gas assets for impairment at the date of transition to IFRSs in accordance with IFRS 6 **Exploration for and Evaluation of Mineral Resources** and IAS 36 **Impairment of Assets** and to recognise any identified impairment loss.

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Deemed cost for assets used in operations subject to rate regulation

Operations are considered to be subject to rate regulation if they provide services or products to customers at prices established by legislation, an independent regulator or other authorised body that are designed to recover the cost of providing the services or products and allow the entity to earn a determined return on investment. The carrying amounts of such assets under previous GAAP may include items that do not qualify for capitalisation under IFRSs (e.g. an imputed cost of equity).

Under the proposals, an entity with property, plant and equipment for use in operations subject to rate regulation could elect (on an item-by-item basis) to measure those assets at the date of transition to IFRSs using their carrying amount under previous GAAP as a deemed cost. However, this exemption would be available only when both retrospective restatement and the use of fair values is impracticable (as defined in IAS 8 **Accounting Policies, Changes in Accounting Estimates and Errors)**.

Entities would also be required to test the items to which this exemption is applied for impairment at the date of transition to IFRSs in accordance with IAS 36 **Impairment of Assets** and to recognise any identified impairment loss.

Determination as to whether an arrangement contains a lease

Under IFRIC 4 **Determining whether an Arrangement contains a Lease**, the assessment as to whether an arrangement contains a lease is made at the inception of the arrangement. IFRS 1 currently permits an exemption for first-time adopters which allows them to undertake that assessment for existing arrangements based on facts and circumstances at the date of transition to IFRSs. However, if this exemption is not availed of, the entity is required to refer to facts and circumstances at the inception of the arrangement.

The ED acknowledges that some entities may have previously applied IFRIC 4 (or an identical requirement) at a date other than the inception of the arrangement and proposes that such entities should not be required to reassess that conclusion when they adopt IFRSs.

The Board also contemplated whether it might be appropriate to amend IFRS 1 to allow an exemption similar to the one proposed for IFRIC 4 in other situations where previous GAAP allowed for the same prospective application as IFRSs but from a different effective date. The Board decided not to move ahead with any such amendment because it did not believe that there are many instances where this would be the case, other than IFRIC 4.

When will the revised requirements apply?

The effective date of these proposed amendments (if accepted) has not yet been determined. The IASB's project plan anticipates a revised Standard in the second half of 2009.

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