EFRAG

European Financial Reporting Advisory Group

28 January 2009

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Dear Madam/Sir

Re: Exposure Draft of Proposed Amendments to IFRS 1 *Additional Exemptions for First-time Adopters*

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft of Proposed Amendments to IFRS 1 *Additional Exemptions for First-time Adopters* (the ED). This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive amendments on the issues.

IFRS 1 sets out exemptions to the normal requirements of IFRS that can be applied when an entity prepares its first set of financial statements in compliance with IFRS (ie when an entity is a 'first-time adopter'). The IASB's objective, when it was developing IFRS 1, was to ensure that an entity's first IFRS financial statements (and its interim financial reports for part of the period covered by those financial statements) contain high quality information that is transparent for users and comparable over all periods presented, provides a suitable starting point for accounting under IFRSs, and can be generated at a cost that does not exceed the benefits for users. IFRS 1 provides some relief from the requirements in IFRS that would otherwise apply in order to ensure that the cost/benefit objective in particular is met.

The objective of this proposed amendment to IFRS 1 is to include certain additional exemptions in IFRS 1 so that first-time adopters from the jurisdictions that are expected to adopt IFRS over the next few years are also able to prepare financial statements that meet the above criteria. The areas where additional exemptions are proposed are:

- deemed cost for oil and gas assets, and disclosures relating to those assets,
- changes in existing decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment,

- deemed cost for assets used in operations subject to rate regulation, and
- determination of whether or not an arrangement involves a lease.

EFRAG is generally supportive of the amendments proposed, believing that a good case has been made for granting relief in the circumstances described and that the relief that it is proposed should be granted is appropriate.

Our detailed comments are set out in the appendix to this letter.

We hope that you find our comments helpful. If you wish to discuss them further, please do not hesitate to contact Mark Abela, Jeff Waldier or me.

Yours sincerely,

Stig Enevoldsen
EFRAG, Chairman

Appendix
EFRAG's detailed comments on the ED of Proposed Amendments to IFRS 1 *Additional Exemptions for First-time Adopters*

RESPONSES TO THE INVITATION TO COMMENT IN THE ED

Question 1—Deemed cost for oil and gas assets

The exposure draft proposes that an entity that used full cost accounting under its previous GAAP may elect, at the date of transition to IFRSs, to measure exploration and evaluation assets at the amount determined under the entity's previous GAAP and to measure oil and gas assets in the development or production phases by allocating the amount determined under the entity's previous GAAP for those assets to the underlying assets pro rata using reserve volumes or reserve values as of that date.

Do you agree with the proposed deemed cost option for entities using full cost accounting under previous GAAP? Why or why not? If not, what alternative do you propose and why?

1 EFRAG agrees with the proposal in the ED to grant first-time adopters some relief from these requirements. We also agree that that relief should involve permitting such entities to use previous GAAP carrying amounts for oil and gas assets, even though the carrying amount for development and production assets will be based on an allocation of the full cost in the cost centre. EFRAG therefore also supports the proposal that a mandatory impairment test be required when an entity takes advantage of the proposed relief. Such a test will help ensure that the transition date deemed cost, if based on the previous GAAP carrying amount, is a suitable starting point for the accounting under IFRSs.

2 EFRAG also agrees with the proposal in the ED to recognise any difference between decommissioning, restoration and similar liabilities measured at transition date in accordance with IAS 37 and the liability determined at that same date under the entity's previous GAAP directly in retained earnings.

Question 2—Oil and gas assets—disclosure

The exposure draft proposes that if an entity uses the exemption described in Question 1 above, it must disclose that fact and the basis on which it allocated the carrying amounts to the underlying assets.

Do you agree with the proposed disclosure requirements relating to the deemed cost option for oil and gas assets? Why or why not?

3 EFRAG agrees with the proposed disclosure requirements relating to the deemed cost option for oil and gas assets. However, EFRAG would suggest that the amended text should clarify that the disclosure requirements of IAS 36 would apply at transition.

Question 3—Deemed cost for operations subject to rate regulation

The exposure draft proposes an exemption for an entity with operations subject to rate regulation. Such an entity could elect to use the carrying amount of items of property, plant and equipment held, or previously held, for use in such operations as their deemed cost at the date of transition to IFRSs if both retrospective restatement and using fair value as deemed cost are impracticable (as defined in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors).

Do you agree with the proposed deemed cost option for entities with operations subject to rate regulation? Why or why not? If not, what alternative do you propose and why?

4 This proposal is in line with the existing relief in IAS 8 that applies when it is impracticable to apply a requirement in IFRS retrospectively. However, first-time adopters cannot rely on that relief because it applies only to entities that already apply IFRSs—not to first-time adopters.

5 On the other hand, some would argue that the ED is inconsistent in requiring the application of existing IFRS to be impracticable in this case but not in the case discussed in Question 1; either the proposed exemptions should be available only when it is impracticable to apply existing IFRS or they should be widely available. However, EFRAG supports the proposal that this exemption should be available only when it is impracticable to comply with existing IFRS. When deciding whether to include additional exemptions in IFRS 1, the IASB has to balance comparability between entities within a single industry and within a single jurisdiction with more general comparability. In the case of oil and gas entities applying full cost accounting, many will find it impracticable to apply existing IFRS whilst, in the case of operations subject to rate regulation, relatively fewer entities will find themselves in that position.

6 EFRAG supports the proposal that a mandatory impairment test should be required when an entity takes advantage of the proposed relief, for exactly the same reason it supported a mandatory impairment test in the circumstances discussed in Question 1 (see paragraph 1).

7 EFRAG agrees with the proposed consequential changes regarding changes in existing decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment.

8 We note that this exemption applies to certain rate-regulated entities. Proposed new paragraph 19B explains that "operations are subject to rate regulation if they provide services or products to customers at prices (ie rates) 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." It seems to us that rate regulation encourages a type of 'cost plus' perspective that can in turn encourage the inclusion as part of the cost of items of PP&E of amounts that do not qualify for capitalisation in accordance with IFRSs. In our view, the key issue here is not that the operation is <u>rate</u> regulated, but that it is regulated in a way that focuses attention on the <u>cost plus notion</u>. We would therefore

encourage the IASB to focus its exemption more on regulation by reference to the cost plus notion.

Question 4—Leases

The exposure draft proposes that if a first-time adopter made the same determination under previous GAAP as that required by IFRIC 4 Determining whether an Arrangement contains a Lease but at a date other than that required by IFRIC 4, the first-time adopter need not reassess that determination when it adopts IFRSs.

Do you agree with the proposal not to require the reassessment of whether an arrangement contains a lease in the circumstances described in this exposure draft? Why or why not?

9 EFRAG agrees with the proposal that, when a first-time adopter has made the same determination under previous GAAP as that required by IFRIC 4 *Determining whether an Arrangement contains a Lease* at a date prior to that required by IFRIC 4, existing IFRS should be amended so that it is not required to reassess that determination when it adopts IFRSs.

Question 5—Assessments under previous GAAP before the date of transition to IFRSs

The Board considered whether to modify IFRS 1 so that entities need not reassess, at the date of transition to IFRSs, prior accounting if that prior accounting permitted the same prospective application as IFRSs with the only difference from IFRSs being the effective date from which that accounting was applied. In this regard, the Board noted that any such proposal must apply to identical, rather than similar accounting, because it would be too difficult to determine and enforce what constitutes a sufficient degree of similarity. The Board decided not to adopt such a modification because it concluded that the situation referred to in Question 4 is the only one in which relief of this type is needed.

Do you agree that the situation referred to in Question 4 is the only one in which additional relief of this type is needed? If not, in what other situations is relief necessary and why?

10 EFRAG is not aware of any other situations in which the problem described in Question 4 arises.