DRAFT COMMENT LETTER

Comments should be submitted by 21 January 2011 to Commentletters@efrag.org

XX January 2011

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

Dear Sir / Madam

Re: Request for views on *Effective Dates and Transition Methods*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Request for Views on *Effective Dates and Transition Methods* (the Request for Views). This letter is submitted in EFRAG's capacity of contributing to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of standards or interpretations in the European Union and European Economic Area.

EFRAG's detailed comments are set out in the appendix to this letter, but to summarise:

- To maintain comparability between financial statements, EFRAG believes that the standards resulting from the projects on *Revenue from Contracts with Customers*, *Leases*, *Insurance Contracts*, *Financial Instruments (IFRS 9)* and *Fair Value Measurement* should have a single effective date of 1 January 2015 at the earliest.

- Early adoption of the standards resulting from the projects on *Post-employment benefits – Defined benefit plans*, *Presentation of items of Other Comprehensive Income*, *Consolidation* and *Joint Arrangements* should be permitted. The effective dates of these standards could be considered on a case-by-case basis.

- EFRAG notes that for some projects that are subject to the IASB's Request for Views, the deliberations have not been completed yet and that the corresponding transition methods have not been decided upon. In particular, we believe that in its deliberations the IASB should specifically consider the needs of those companies that want to adopt the final standard on financial instruments in its entirety rather than in phases.

- We believe that different effective dates and permitting earlier adoption for first-time adopters might be considered for purely pragmatic reasons.

To form an opinion on both comments, EFRAG has raised the correspondent questions to constituents.

If you wish to discuss our comments further, please do not hesitate to contact Joaquin Sanchez-Horneros or me.

Yours sincerely

Francoise Flores
EFRAG, Chairman

Appendix

Notes for EFRAG's constituents

1 *When the IASB or IFRS Interpretations Committee issue a new or amended standard or Interpretation they specify an effective date and set out requirements as to how entities should transition to the new guidance.*

2 *The default approach under IAS 8* Accounting Policies, Changes in Accounting Estimates and Errors *is to require full retrospective application of new standards (i.e. the opening balances are restated as if the new policy had always been applied, except to the extent that this is impracticable). However, some standards permit prospective application or hybrid approaches that aim to (1) reduce the cost of transition and/or (2) avoid undue use of hindsight. Early application is often permitted.*

3 *EFRAG has generally taken the view that the transition methods are important from a user perspective because they may reduce comparability. As a result, EFRAG's position has generally been that it strongly favours full retrospective application. Indeed, if the choice is between implementing a new standard now but prospectively or implement it later but retrospectively, EFRAG has to date favoured the latter.*

4 *From our discussions with users of financial statements, we understand that:*

- *(a) Some were concerned about having too many restatements of past information (i.e. every time a new IFRS or Interpretation was issued), they would prefer a stable platform.*
- *(b) Some have pointed out that having comparable information for the comparable three years was important to enable them to perform their ratio analysis and make forecasts going forward.*
- *(c) Finally, some users have remarked that if there is hindsight involved or the information was difficult to compute then it should not be given. In such cases, prospective application would be acceptable.*

Question 1

Please describe the entity (or the individual) responding to this Request for Views.

For example:

(a) Please state whether you are primarily a preparer of financial statements, an auditor, or an investor, creditor or other user of financial statements (including regulators and standard-setters). Please also say whether you primarily prepare, use or audit financial information prepared in accordance with IFRSs, US GAAP or both.

(b) If you are a preparer of financial statements, please describe your primary business or businesses, their size (in terms of the number of employees or other relevant measure), and whether you have securities registered on a securities exchange.

(c) If you are an auditor, please indicate the size of your firm and whether your practice focuses primarily on public entities, private entities or both.

(d) If you are an investor, creditor or other user of financial statements, please describe your job function (buy side/sell side/regulator/credit analyst/lending officer/standard-setter), your investment perspective (long, long/short, equity, or fixed income), and the industries or sectors you specialise in, if any.

(e) Please describe the degree to which each of the proposed new IFRSs is likely to affect you and the factors driving that effect (for example, preparers of financial statements might explain the frequency or materiality of the transactions to their business and investors and creditors might explain the significance of the transactions to the particular industries or sectors they follow).

EFRAG's detailed response

5 In response to Question 1:

(a) EFRAG (European Financial Advisory Reporting Group) is a private sector body set up by the European organisations prominent in European capital markets. In addition, to providing proactive input into the work of the IASB, EFRAG advises the European Commission on the endorsement of standards and interpretations in the European Union and European Economic Area.

(b) Not applicable.

(c) Not applicable.

(d) Not applicable.

(e) Not applicable.

Question 2

Focusing only on those projects included in the table in paragraph 18 of IASB Request for Views:

(a) Which of the proposals are likely to require more time to learn about the proposal, train personnel, plan for, and implement or otherwise adapt?

(b) What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?

Notes for EFRAG's constituents

6 The table below summarises the different transition methods that have been chosen by the IASB for each of the projects that it is consulting on. The proposed transition method differs from project to project depending on the facts and circumstances of each project as evaluated on a stand-alone basis.

Project	***Transition***
Consolidation	*Retrospective*
Fair value measurement	*Prospective*
Financial instruments (IFRS 9) †	*Retrospective*
Insurance contracts	*Limited retrospective*
Joint arrangements	*Limited retrospective*
Leases	*Limited retrospective*
Post-employment benefits – Defined benefit plans	*Retrospective*
Presentation of items of other comprehensive income	*Retrospective*
Revenue from contracts with customers	*Retrospective*

† IFRS 9 is being finalised in phases. The first part of phase 1 of IFRS 9, specifying the requirements for financial assets, was issued in November 2009. The second part of phase 1 of IFRS 9, specifying the requirements for financial liabilities, has been issued in October 2010. The remaining phases (impairment, hedge accounting, asset and liability offsetting) are still under discussion and transition methods for these phases have not been finalised.

7 One of the options suggested to facilitate retrospective application would be to delay the effective date as this would give entities more time to collect data and prepare their systems for collection of comparative information.

8 The costs expected to be incurred upon adoption of the new standards depend heavily on the transition methods and may include the following:

(a) understanding of the new accounting requirements;

(b) changes to charts of accounts;

(c) system changes necessary to collect the required comparative data and enable future reporting;

(d) project management in groups with many subsidiaries;

(e) training of staff; and

(f) changes in external communications and education of analysts.

EFRAG's detailed response

Questions to constituents

9 Assuming that the IASB finalises the above projects without any significant changes compared to the Exposure Draft or subsequent Staff Draft:

(a) Which of the proposals are likely to require more time to learn about the proposal, train personnel, plan for, and implement or otherwise adapt?

(b) What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?

(c) Are there any other changes that you would expect to make (e.g. changes in contracts or general terms and conditions in advance of the new reporting requirements)?

10 Has the IASB made any tentative decisions after issuing the Exposure Draft or subsequent Staff Draft that would change your answer to the questions above?

Question 3

Do you foresee other effects on the broader financial reporting system arising from these new IFRSs? For example, will the new financial reporting requirements conflict with other regulatory or tax reporting requirements? Will they give rise to a need for changes in auditing standards?

Notes for EFRAG's constituents

11 EFRAG is aware that in some jurisdictions IFRS based financial information is used as the basis for statutory financial reporting, taxation, dividend distributions, national statistics, reporting to supervisors, debt covenants, profit-sharing agreements and employee benefits.

EFRAG's detailed response

Question to constituents

12 Do you foresee other effects on the broader financial reporting system arising from these new IFRSs?

Question 4

Do you agree with the transition method as proposed for each project, when considered in the context of a broad implementation plan covering all the new requirements? If not, what changes would you recommend, and why? In particular, please explain the primary advantages of your recommended changes and their effect on the cost of adapting to the new reporting requirements.

EFRAG's detailed response

13 EFRAG has some concerns in some of the proposals:

(a) As noted in our [draft] comment letter on the Exposure Draft on *Insurance Contracts*:

(i) We disagree with setting to zero the residual margin for contracts in force at transition;

(ii) We believe that the final standard should require retrospective application in accordance with IAS 8; and

(iii) In order to minimise the operational burden it is crucial that insurance companies will have the opportunity to apply IFRS 9 and the final insurance contracts standard at the same time.

(b) As noted in our [draft] comment letter on the Exposure Draft on *Leases*:

(i) We agree that mandatory full retrospective application would be onerous for long-term leases, and welcome the relief given to preparers.

(ii) In general terms, EFRAG is in favour of full retrospective application. We appreciate the reasons why the IASB is not mandating it, but we do not think that there are conceptual reasons to prohibit it when entities have the relevant information.

(iii) However, if the IASB decided to allow an option for transition rules, we recommend that entities should treat it as an accounting policy option in accordance with paragraph 13 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Therefore, an entity that decides to adopt full retrospective application should do that for all arrangements for which the entity has the relevant information.

(iv) Paragraph 91 of the Exposure Draft requires that when lease payments are uneven over the lease term, a lessee shall adjust the right-of-use asset recognised at the date of initial application by the amount of any recognised prepaid or accrued lease payments. Paragraph BC190 of the ED explains that this occurs when lease payments include relatively large amounts at the beginning or the end of the lease term. We understand that the requirement in paragraph 91 should apply only to unavoidable lease payments; however "lease payments that are uneven over the lease terms" may be read to also include contingent rentals. We suggest amending the definition in order to clarify that this is not the case.

(v) Paragraph 29 of the Exposure Draft requires a lessor to assess its exposure to significant risks and benefits associated with the underlying asset at inception of the lease. This assessment shall not be reassessed subsequently.

(vi) We note that the transition requirements in paragraphs 94 and following do not specify at what date lessors should assess their exposure to risks and benefits when first applying the new rules. EFRAG recommends that it is specified that this assessment should be made at the transition date based on the information available at that time.

(c) As noted in our comment letter on the Exposure Draft on *Revenue from Contracts with Customers*:

(i) EFRAG agrees that the proposed requirements should be applied retrospectively, but this retrospective application might be difficult in practice under some circumstances.

(ii) If prospective application were to be required, this could result in the same revenue being recognised twice (or not at all) in the same set of financial statements. Alternatively, if the prospective application would require the new revenue recognition model to be applied only for new contracts, an entity could apply different revenue recognition criteria to identical contracts agreed at different times. To avoid these types of anomalies, which cause confusion among users, we favour retrospective application.

(d) As noted in our comment letter on the Exposure Draft on *Amendments to IAS 19 Employee Benefits*:

(i) EFRAG's strong preference is that all new or amended accounting requirements should be applied retrospectively, because this significantly enhances the comparability and usefulness of the information provided. Therefore, although we do not agree with the IASB on the due process applied to the proposals in this ED, if the Board were to proceed with these proposals, we would support the proposed retrospective application.

(ii) We also note that the ED itself does not include transitional requirements. We agree that in accordance with paragraph 19(b) of IAS 8, if an entity changes an accounting policy upon initial application of an IFRS that does not include specific transitional provisions, the changes should be applied retrospectively. Nevertheless, we believe that it would be clearer if the transitional requirements are included explicitly in the text of the amendment.

(e) As noted in our comment letter on the Exposure Draft on *Presentation of Items of Other Comprehensive Income (Proposed amendments to IAS 1)*:

(i) EFRAG agree with the IASB's explanation and reasoning in paragraph BC97 of the ED for retrospective application of the proposed amendments, but considers that it would be helpful to add the wording from paragraph 13 of IFRIC 19: 'An entity shall apply a change in accounting policy in accordance with IAS 8 from the beginning of the earliest comparative period presented.'

(f) EFRAG has no significant concerns in relation to the proposals on transition method and effective date of the Exposure Draft on *Fair value measurement*.

For more details on these concerns, EFRAG refers to its comment letters on these standards.

14 We note that EFRAG has already commented in the past on the transition methods and effective dates regarding the projects on Consolidation and Joint Arrangements. Those comments are not repeated here as we are not in a position to assess whether our earlier comments would remain valid given ongoing work on these projects.

Questions to constituents

15 Do you have any comments on the transition methods that the IASB has proposed in the Staff Draft on *Consolidated Financial Statements*?

16 Do you have any comments on the transition methods for *Joint Arrangements* that the IASB has discussed in its May 2010 meeting (as described on the IASB's website)?

17 EFRAG notes that not all phases of the project on financial instruments have been completed and that the corresponding transition methods have not been decided upon. However, we believe that in its deliberations the IASB should specifically consider the needs of those companies that want to adopt the final standard on financial instruments in its entirety rather than in phases.

Question 5

In thinking about an overall implementation plan covering all of the standards that are the subject of this Request for Views:

(a) Do you prefer the single date approach or the sequential approach? Why? What are the advantages and disadvantages of your preferred approach? How would your preferred approach minimise the cost of implementation or bring other benefits? Please describe the sources of those benefits (for example, economies of scale, minimising disruption, or other synergistic benefits).

(b) Under a single date approach and assuming the projects noted in the introduction are completed by June 2011, what should the mandatory effective date be and why?

(c) Under the sequential approach, how should the new IFRSs be sequenced (or grouped) and what should the mandatory effective dates for each group be? Please explain the primary factors that drive your recommended adoption sequence, such as the impact of interdependencies among the new IFRSs.

(d) Do you think another approach would be viable and preferable? If so, please describe that approach and its advantages.

Notes for EFRAG's constituents

18 In accordance with IASB request for views, there are two main approaches for the implementation of the standards:

(a) A single date approach – all new IFRSs would become effective at the same date, following an appropriate implementation period.

(b) A sequential approach – each new IFRS, or an appropriate group of new IFRSs, would become effective at different dates spanning a number of years.

19 EFRAG understands that many preparers of financial statements would prefer a single date approach because this would (1) reduce the need to educate users *about changes in financial reporting on a piecemeal basis and (2) ensure consistent financial reporting within industries.*

EFRAG's detailed response

20 EFRAG considers that the single date approach has the following advantages:

(a) It would maintain comparability of financial information between companies as they would apply the same standards at any given point in time;

(b) It would mitigate the loss of comparability over time as companies could avoid incremental changes in accounting policies that take place over a series of years. As the changes proposed are pervasive, EFRAG believes that a significant lead-time for implementation would be required. A single date approach would avoid creating a prolonged period in which the comparability of financial reports may be significantly reduced;

(c) It would avoid the complexity that results from permitting 'buffet-style' selection of new accounting policies, such as the issues associated with:

(i) competing and overlapping consequential amendments (i.e. several new standards need to amend the same paragraph of another standard);

(ii) conflicting scope requirements between old and new standards (e.g. accounting for guarantees and warranties); and

(iii) conceptual inconsistencies that might result from an unrestricted selection of new accounting policies by companies.

Therefore, we believe that the single date approach would be favourable from the point of view of users, preparers, regulators, standard-setters and auditors.

21 For these reasons, EFRAG believes it would be necessary to distinguish between two groups of standards:

(a) *Group 1* – Revenue from Contracts with Customers, Leases, Insurance Contracts, Financial Instruments (IFRS 9) and Fair value measurement.

These standards are the cornerstones of financial reporting under IFRSs, in the sense that they have a significant impact on the way companies report the performance of their core business, they affect a large number of items and transactions and their scopes of application are closely related. Also, in some industries (e.g. insurance), application of some standards before the others could reduce the relevance of financial reporting.

For the reasons mentioned in paragraph 20 above, EFRAG believes that a single date approach should apply to these projects as a package. If the IASB were to complete the standards in Group 1 in June 2011, we believe that their collective effective date should be 1 January 2015 at the earliest because:

(i) These standards have a pervasive effect on the financial statements and would need to be applied largely retrospectively;

(ii) Collecting comparative information under the new standards would often require companies to assess facts and make the required judgements at the time that the underlying transactions occur, as there may not be a straightforward way to convert information from the old to the new standard; and

(iii) In many jurisdictions, the new standards would need to be translated and endorsed or may require amendments to the legal or tax framework.

Finally, if some of the standards in this group were to be completed later than currently expected, this might require an effective date after 1 January 2015.

(b) *Group 2* – Post-employment benefits – Defined benefit plans, Presentation of items of Other Comprehensive Income, Consolidation and Joint Arrangements.

EFRAG believes that the arguments mentioned in (a) above do not apply to this group of projects because, while important, they have a more contained and discrete effect on financial reporting and on the preparation of financial statements. EFRAG believes that there are no compelling arguments to deny companies the flexibility to adopt improved versions of the resulting standards early. In addition, the effective dates of these standards should be before those in Group 1, but could otherwise be considered on a case-by-case basis.

Question to constituents

23 What do you believe the effective date for the standards in Group 1 should be?

24 In relation to the IASB's work programme, EFRAG believes that projects should not be subject to rigid deadlines, rather the schedule for their completion should allow for careful redeliberation, proper due process and field-testing to ensure the quality and relevance of the resulting financial reporting. Therefore, should the completion of individual standards in Group 1 take more time than currently envisaged (e.g. the project on insurance contracts), we would urge the IASB to reconsider the impact on the transition methods and effective dates on the other standards in Group 1.

Question 6

Should the IASB give entities the option of adopting some or all of the new IFRSs before their mandatory effective date? Why or why not? Which ones? What restrictions, if any, should there be on early adoption (for example, are there related requirements that should be adopted at the same time)?

EFRAG's detailed response

25 As noted in our response to Question 5:

(b) Early adoption would <u>not</u> be appropriate for the projects in Group 1 (i.e. Revenue from Contracts with Customers, Leases, Insurance Contracts, Financial Instruments (IFRS 9) and Fair value measurement). EFRAG believes that a significant lead-time for implementation would be required because the changes proposed by these projects are pervasive. To avoid creating a prolonged period in which the comparability of financial reports may be significantly reduced, it would not be appropriate to permit early adoption;

(c) Early adoption should be permitted for the projects in Group 2 (i.e. Post-employment benefits – Defined benefit plans, Presentation of items of Other Comprehensive Income, Consolidation and Joint Arrangements).

Question to constituents

26 Do you agree that early adoption should be permitted for the standards in Group 2?

Question 7

Do you agree that the IASB and FASB should require the same effective dates and transition methods for their comparable standards? Why or why not?

EFRAG's detailed response

27 EFRAG would like to reiterate that the main and primary objective for the IASB is to issue high quality standards that have effective dates and transition methods suitable to companies reporting under IFRSs. Convergence with other GAAPs in terms of effective dates and transition methods, while desirable, should not come at the expense of those companies already applying IFRSs.

Question 8

Should the IASB permit different adoption dates and early adoption requirements for first-time adopters of IFRSs? Why, or why not? If yes, what should those different adoption requirements be, and why?

Notes for EFRAG's constituents

28 In accordance with IASB request for views, there are two main approaches for the implementation of the standards:

(b) Allow first-time adopters to adopt the new and revised IFRSs early, even if existing preparers are restricted in their ability to adopt early (see question 6 above).

(c) Allow first-time adopters to defer adoption of some or all of the new and revised IFRSs for a number of years.

EFRAG's detailed response

29 EFRAG considers that providing different effective dates and early adoption requirements for first-time adopters might be considered for purely pragmatic reasons (i.e. first-time adopters would not have to adopt standards that are about to be abolished). However, the desire to provide a 'stable platform' to first-time adopters should not result in a mandatory acceleration of effective dates for existing preparers.