EFRAG
European Financial Reporting Advisory Group

31 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*

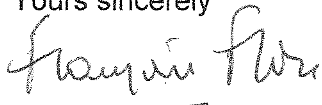
On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Request for Views on *Effective Dates and Transition Methods* (the 'Request for Views'). This letter is submitted in EFRAG's capacity as contributor to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on the 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. In summary, these are:

- 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 yet been completed and that the corresponding transition methods have not been decided upon. In particular, we believe that the IASB, in its deliberations, should specifically consider the needs of those companies that wish 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 should be considered for purely pragmatic reasons.

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

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

1 In response to Question 1:

(a) EFRAG (the European Financial Advisory Reporting Group) is a private sector body set up in 2001 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?

EFRAG's detailed response

The projects which are expected to be most costly and complex to implement are those on *Leases*, *Insurance Contracts*, *Revenue from Contracts with Customers* and *Financial instruments* (IFRS 9).

The main costs expected to be incurred by our constituents are those related to the assessment of the new proposals and their impact on business activities, developing and adapting IT Systems, training of personnel, communications with analysts and internal controls.

2 Based on comments received from its constituents, EFRAG believes that the main types of costs they will incur in relation to these projects are those related to:

(a) assessing the new accounting requirements and their impact on the business itself – particularly in the context of revenue recognition and leases, where very large transaction streams are affected and the impacts are quite considerable. For example, analysing the impact of the leasing proposals on portfolios of leases (for example, in the retail and telecommunications industries) is very costly. Similarly, determination of the impact of the revenue recognition proposals by software and telecommunications companies is very costly.

(b) developing the IT and system changes necessary to collect the required comparative data (particularly when fully retrospective application is required) and enable future reporting – for example, our constituents note the need:

(i) to produce new information, not required currently, in order to calculate expected losses on financial instruments under the proposed new approach;

(ii) to implement new processes to capture the relevant information regarding leases (for example, modifications and estimates);

(iii) to develop systems that are not strictly transaction driven, as is currently the case, but that need to be capable of allocating revenue to individual performance obligations and processing related estimates;

(c) training of staff – staff will need to receive a significant amount of training in order to be able to make the judgements and estimates required by, for example, the proposals on revenue from contracts with customers, leases, insurance contracts, hedge accounting, consolidation and joint arrangements;

(d) changing the communications with analysts and education of analysts – these costs are especially significant where the new standards have considerable impact on the financial and performance ratios of the issuers. In addition, there may well be differences between external reporting and internal reporting (for example, in the way income is reported);

(e) reviewing, redesigning, testing and implementing new internal control and reporting procedures; and

(f) obtaining the necessary information to meet the new disclosure requirements.

We would like to note that the costs related to the major standards that we have included in Group 1 (i.e. *Revenue from Contracts with Customers*, *Leases*, *Insurance Contracts* and *Financial Instruments*) are expected to be much higher than those related to the other standards.

3 We specifically would like to draw the IASB's attention to the point that adequate effect studies should be performed, in order to ensure that the benefits of the proposals outweigh the costs.

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?

EFRAG's detailed response

EFRAG believes that there are important consequences for the broader financial reporting system – the importance of which cannot be estimated at this stage – that the IASB should take into consideration.

4 Until the IASB finalises the different standards, it is difficult to assess fully the magnitude of the impact of new standards and, in consequence, the number and exact nature of the conflicts with regulatory and tax requirements.

5 Based on responses from our constituents, we have identified the following areas where the changes in IFRSs have consequences outside financial reporting:

(a) Tax authorities in several countries in the EU currently require tax returns (e.g. for income tax and value added tax) to be based on IFRS information in the stand-alone or consolidated IFRS financial statements. Those tax authorities may impose new requirements on companies reporting under IFRS to deal with the change in accounting; this would likely result in additional costs for these companies.

(b) In the European Union, some local regulators require companies to present two comparative periods rather than one comparative period, as required by IAS 1 (for example, under the European Union Prospectus Directive). In addition, those companies may need to present an opening IFRS statement of financial position in accordance with IFRSs. Therefore, a longer transitional period would be needed to allow companies to collect the required comparative information.

(c) Insurance and banking legislation is being revised in many jurisdictions in the wake of the financial crisis; insurance companies in the EU will need to apply the Solvency II Directive and banks in the EU will need to apply the Basel 3 solvency requirements. This raises two issues that the IASB should consider:

(i) concurrent implementation of these new solvency requirements and implementation of significantly revised financial reporting standards will put a great burden on certain companies in these industries. Nevertheless, some benefits may exist as a result of synergies arising from simultaneous implementation of these changes; and

(ii) to some extent solvency requirements in most jurisdictions take financial reporting as the basis for regulatory reporting. Simultaneous changes in both the solvency and financial reporting requirements have the potential to create significant uncertainty and complexity for companies in the industries affected.

(d) We would like to draw the IASB's attention to the fact that many jurisdictions (including the EU) that have some form of endorsement process would need some additional time to complete this process (for example, this would include the time needed for proper due process and effect studies).

(e) Finally, in many other areas where IFRS-based financial information is used in the stand-alone financial statements, there may be important effects arising from these new IFRSs (also for example, on determining distributable reserves and national statistics).

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

EFRAG refers to its comment letters on the different projects.

6 EFRAG has some concerns in some of the proposals:

(a) As noted in its comment letter on the Exposure Draft on *Insurance Contracts*, EFRAG:

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

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

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

(b) As noted in its comment letter on the Exposure Draft on *Leases*:

(i) EFRAG is generally in favour of full retrospective application. Lease arrangements may have long durations. Therefore, in some instances entities may not have the information to apply fully new retrospective requirements. However, such concerns would be addressed by IAS 8, which requires the retrospective application of an accounting policy, unless it is impracticable to do so.

(ii) 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 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.

(iii) 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.

(iv) We note that the transition requirements from paragraphs 94 onwards 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 from the beginning of the current period, 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 agrees 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 the 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 projects.

7 Of note, EFRAG has previously commented 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.

8 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 the IASB, in its deliberations, should specifically consider the needs of those companies that wish 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.

EFRAG's detailed response

EFRAG believes that the collective effective date of the standards on *Leases, Insurance Contracts, Revenue from Contracts with Customers, Financial instruments* and *Fair Value Measurement* should be 1 January 2015, at the earliest.

The effective dates of the other standards could be considered on a case-by-case basis.

9 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 a 'buffet-style' selection of new accounting policies, such as the issues associated with:

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

(ii) conflicting scope requirements between old and new standards (for example, accounting for guarantees and warranties); and

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

10 However, in the case of certain other new standards the disadvantages of not using a single date approach are limited. This is true, in particular, when the guidance in these standards is relatively self-contained (i.e. their scope and consequential amendments do not overlap) and their impact on financial reporting is not pervasive. In those cases, the benefits of allowing companies to decide on the best time to adopt the new requirements and the possible improvements in the standards may be compelling.

11 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 (for example, insurance), the application of some standards before others could reduce the relevance of financial reporting.

For the reasons outlined in paragraph 9 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 by June 2011, we believe that their collective effective date should be 1 January 2015, at the earliest, for the following reasons:

(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 paragraphs 9 and 11(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. For the reasons noted in paragraph 10 above, EFRAG believes that there are no compelling arguments to deny companies the flexibility to adopt new versions of the resulting standards early. These projects are not deeply interrelated. Besides, these proposals are either not significant in their effects or they enhance comparability (for example,the deletion of the corridor approach on IAS 19). We consider that the effective dates of these standards might be before those in Group 1, but could otherwise be considered on a case-by-case basis. However, in the case of the *Consolidation* and *Joint Arrangement* projects, we ask the IASB to keep in mind that their effective date should be the same and that such effective date may need to be later to ensure that the requirements of these standards are understood consistently.

12 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

EFRAG prefers not to permit early adoption of those projects included in Group 1 in Question 5. However, early adoption should be permitted for the projects in Group 2.

13 As noted in our response to Question 5:

(a) Early adoption would not be appropriate for the projects in Group 1: *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.

(b) Early adoption should be permitted for the projects in Group 2: *Post-employment Benefits – Defined Benefit Plans*, *Presentation of Items of Other Comprehensive Income*, *Consolidation* and *Joint Arrangements.*

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

Primary objective should be to issue high quality standards that have effective dates and transition methods suitable to companies reporting under IFRSs.

14 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?

EFRAG's detailed response

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

15 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.