Agenda ref **10A**

STAFF PAPER

17 January – 18 January 2012

IFRS Interpretations Committee Meeting

[this box can be used to give additional meeting dates]

Project	**2009-2011 Annual improvements cycle (ED June 2011)—Comment letter analysis**
Paper topic	IFRS 1 *First-time Adoption of International Financial Reporting Standards*—Repeated application of IFRS 1

CONTACT(S)	Leonardo Piombino	lpiombino@ifrs.org	+44 (0)20 7246 05 71
	Denise Durant	ddurant@ifrs.org	+44 (0)20 7246 64 69

Introduction

1. The exposure draft of proposed *Improvements to IFRSs* published in June 2011 (hereafter, the ED) includes a proposal for an amendment to clarify that an entity is required to apply IFRS 1 *First-time Adoption of International Financial Reporting Standards* when the entity's most recent previous annual financial statements do not contain an explicit and unreserved statement of compliance with IFRSs, even if the entity has already applied IFRS 1 in a previous reporting period.

Objective of this paper

2. The objective of this paper is to provide an analysis of the comment letters received on the proposal to amend IFRS 1 and to obtain a final decision from the IFRS Interpretation Committee (the 'Committee') to allow this issue to be included in the final *Improvements to IFRSs* planned to be issued in 2012.

Structure of this paper

3. This agenda paper:

   (a) provides background information on the issue;

   (b) analyses the comments received as part of the exposure draft process and recommends changes to the proposed draft wording; and

   (c) requests the Committee to confirm whether they agree with the staff's recommendations to add some modifications to the proposed amendment.

4. Our recommended changes to the draft wording and a draft Basis for Conclusions are included in **Appendix A** and **Appendix B** of this paper.

Background

Current guidance in IFRS 1

5. The scope of IFRS 1 requires that the standard is applied in an entity's first IFRS financial statements. Paragraph 3 of IFRS 1 states that (emphasis added):

> 3 An entity's first IFRS financial statements **are the first annual financial statements in which the entity adopts IFRSs, by an explicit and unreserved statement in those financial statements of compliance with IFRSs**. Financial statements in accordance with IFRSs are an entity's first IFRS financial statements if, for example, the entity:
>
> a) presented its most recent previous financial statements:
>
> (i) in accordance with national requirements that are not consistent with IFRSs in all respects;
>
> (ii) in conformity with IFRSs in all respects, except that the financial statements did not contain an explicit and unreserved statement that they complied with IFRSs;

(iii) containing an explicit statement of compliance with some, but not all, IFRSs;

(iv) in accordance with national requirements inconsistent with IFRSs, using some individual IFRSs to account for items for which national requirements did not exist; or

(v) in accordance with national requirements, with a reconciliation of some amounts to the amounts determined in accordance with IFRSs;

…

Issue that led to the proposed amendment

6. IFRS 1 does not provide guidance on whether:

   (a) the presentation of IFRS-compliant financial statements, before the entity's most recent previous financial statements, should be considered in applying IFRS 1; or

   (b) whether an entity can apply IFRS 1 more than once.

The Board's proposal to address the issues raised

7. At the July 2010 Committee meeting[1], the Committee observed that:

   (a) IFRS 1 does not prohibit an entity from applying the guidance for first-time adoption more than once; and

   (b) the rationale in paragraphs BC4 and BC 5 of IFRS 1 is that an entity has adopted IFRSs if, and only if, its most recent previous financial statements contain an explicit and unreserved statement of compliance with IFRSs.

[1] http://www.ifrs.org/NR/rdonlyres/29E239AF-8B65-4438-9D7C-6952EAED5BAA/0/1007obs9IFRS1.pdf

8. The Committee supported the view that IFRS 1 should be applied when an entity meets the scope requirements of paragraph 3 of IFRS 1, regardless of whether the entity has previously applied IFRS 1. Consequently, the Committee decided to recommend that the Board should clarify the guidance relating to the repeated application of IFRS 1 as part of Annual Improvements.

9. At the Board meeting in October 2010[2], the Board agreed with the Committee that the scope of IFRS 1 lacks clarity relating to the requirement that an entity should apply IFRS 1 for a second time.

10. Consequently, the Board decided that IFRS 1 should be amended to clarify that an entity is required to apply IFRS 1 each time that it prepares and presents financial statements that meet the definition of its first IFRS financial statements, even if the entity has applied IFRS 1 in a previous reporting period.

11. The proposed amendment to IFRS 1 is reproduced below for ease of reference (emphasis added):

> 2A An entity shall apply this IFRS when the entity's most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with IFRSs, **even if the entity applied this IFRS in a reporting period before the period reported in the most recent previous annual financial statements**.

12. In this paper, we discuss and analyse the comments received from constituents during the comment period, which ended on 21 October 2011.

Comment letter analysis

13. The Board received 67 comment letters on the ED *Improvements to IFRSs.*

    (a) Question 1: Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?) [55 respondents answered this question]

[2] http://www.ifrs.org/Meetings/IASB+19+October+2010.htm Agenda Paper 3A.

(b) Question 2: Do you agree with the proposed transitional provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose? [47 respondents answered this question]

14. A majority of the respondents broadly agree with the proposed amendment to IFRS 1 but many raised comments on the proposals, as explained in the following paragraphs.

15. Some of those who partially agree think that in addition to the proposed amendment the Board should also require entities to disclose **('Issue 1')**:

(a) the reason for ceasing reporting under IFRS; and

(b) the reason for re-adoption.

16. Some respondents who partially agree, or disagree, believe that:

(a) an entity that prepares its first IFRS financial statements, even if the entity has previously applied IFRS 1, should be allowed to apply IFRSs retrospectively in its first financial statements[3]. **('Issue 2')**;

(b) the repeated application of IFRS 1 is inappropriate where an entity is unable to express an unreserved statement of full compliance with IFRSs only because an endorsement body (such as the European Union) is late in ratifying an IFRS during its endorsement process (ie the EU endorsed a standard after its effective date)[4] **('Issue 3'**);

(c) when an entity applies IFRSs in its financial statements, but intentionally or unintentionally does not include an explicit and unreserved statement of compliance with IFRSs[5] an entity should not be required to apply IFRS 1 **('Issue 4')**

[3] See Comment Letter (CL) 36 (GASB), CL 38 (Japanese Institute of CPA) and CL 45 (ASBJ)

[4] See CL 5 (Deloitte), CL 12 (BP), CL 22 (Cobham), CL 40 (Moore Stephens), CL 44 (Business Europe), CL 46 (Siemens), CL 63 (Shell International)

[5] See CL 11 (Norwegian Accounting Standard Board), CL 12 (BP) and CL 21 (BDO)

17. The comments and concerns raised by respondents are analysed in subsequent paragraphs.

Issue 1: additional disclosures should be required

18. Some respondents[6] believe that an entity applying IFRS 1 for the second time should be required to disclose that fact together with the reason why it stopped applying IFRSs and now is resuming reporting in accordance with IFRSs.

19. They think that such disclosure would provide greater transparency to users of financial statements and minimise potential abuse of the 'reliefs' provided by IFRS 1, such as those relating to deemed cost, employee benefits and currency translation differences.

Staff analysis and recommendation on Issue 1

20. We think that the risk of an entity's potential abuse of exemptions and exceptions provided by IFRS 1 is limited; because, usually, an entity cannot choose to stop applying IFRSs. However, we understand that the risk could potentially exist and we agree that the suggested disclosure would provide users of financial statements with useful information.

21. Consequently, we think that the Committee should recommend to the Board that it should require that: if an entity applies IFRS 1 and if this entity has previously applied IFRS 1 in the past (ie it is not the entity's first time of applying IFRS 1), the entity should disclose:

    (a) the reason why it stopped applying IFRSs; and

    (b) the reason why it is resuming reporting in accordance with IFRSs.

22. Our recommended changes to the draft wording and a draft Basis for Conclusions are included in Appendix A and Appendix B of this paper.

[6] See CL 26 (CIPFA), CL 33 (MASB), CL 34 (ASC), CL 35 (FEI) and CL 52 (ASB).

Issue 2: Allow, rather than require, the repeated application of IFRS 1

23. Some respondents (CL 36 GASB, CL 38 Japanese Institute of CPA and CL 45 ASBJ) observe that requiring repeated application of IFRS 1 might not be appropriate in certain cases, such as when an entity has applied IFRSs in the past and whose period of discontinuance of applying IFRSs is short. These respondents think that in such cases, an entity should be allowed to apply IFRSs retrospectively in its first financial statements[7] as if the entity had never discontinued the application of IFRSs (ie on a continuation basis rather than being required to apply IFRS 1 afresh). This is because, in their view:

    (a) the retrospective application of IFRSs generates more useful information than IFRS 1, because the latter grants exemptions from, and exceptions to, the application of the requirements in IFRSs; and

    (b) an entity that has applied IFRS in the past may find the application of the full requirements in IFRS, on a continuation basis, 'easier' and not burdensome compared with applying IFRS 1 again.

Staff analysis and recommendation on Issue 2.

24. We observe that paragraph IN5 of IFRS 1 states that this standard grants exemptions from some requirements of IFRSs on the assumption that the cost of complying with some IFRSs would be likely to exceed the benefits to users of financial statements. Consequently, we think that if an entity determines that the benefits of continuing to apply IFRSs would probably exceed the costs of preparing such information (for example, when there is a brief period of discontinuance of applying IFRSs, or where there are few differences between national GAAP and IFRSs), the entity should not be prohibited from following the continuation approach.

[7] We think that this proposal is similar to the requirement for retrospective application in IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* for changes in accounting policies. "Retrospective application" implies the application of a new accounting policy as if the policy had always been applied by an entity.

25. On this basis, we think that the Committee should recommend to the Board that it should allow (rather than require) entities that have previously applied IFRSs to apply IFRS 1. Consequently, the continuation approach could be applied by those who elect to do so.

26. Entities that have never applied IFRSs in the past would continue to be required to apply IFRS 1 in their first IFRS financial statements.

27. Our recommended changes to the draft wording and a draft Basis for Conclusions are included in Appendix A and Appendix B of this paper.

Issue 3: Delay in endorsing an IFRS

28. Some respondents (CL 5 DT, CL 12 BP, CL 22 Cobham, CL 40 Moore Stephens, CL 44 Business Europe, CL 46 Siemens and CL 63 Shell) think that repeated application of IFRS 1 is inappropriate when an entity is unable to express an unreserved statement of full compliance with IFRSs only because an endorsement body is late in ratifying an IFRS during its endorsement process. The following example illustrates this situation:

> **Example**
>
> In Period 1, Entity A is unable to include in its financial statements an explicit and unreserved statement of compliance with IFRSs as issued by the IASB, because IFRS X was not endorsed by Endorsement Body Y prior to its effective date;
>
> In Period 2, IFRS X is endorsed by Endorsement Body Y.
>
> *Is Entity A considered a first-time adopter in accordance with the proposed amendment to IFRS 1 in Period 2?*
>
> According to the wording of the proposed amendment to IFRS 1, Entity A is within the scope of IFRS 1 in Period 2 because Entity A's most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with IFRSs.

29. Respondents who raised this issue do not believe that it is the Board's intention to require the application of IFRS 1 in the above example; consequently, they are asking the Board to review the wording of the proposed amendment.

Staff analysis and recommendation on Issue 3

30. We think that it will be rare that the scenario described above (ie that an endorsement body does not endorse a standard before its effective date) will happen, because we think that the Board will manage its schedules to try to allow sufficient time for the endorsement of a standard by an endorsement body.

31. Consequently, we think that the Committee should not revise the wording of the proposed amendment.

Issue 4: Omission of the statement of compliance

32. Some respondents believe that an entity that applied IFRSs but which intentionally or unintentionally did not include an explicit and unreserved statement of compliance with IFRSs should not be required to apply IFRS 1.

33. In particular, they think that the proposal as drafted has the potential for abuse, because an entity might intentionally omit the statement of compliance with IFRSs in order to obtain benefits through the application of the exemptions provided by IFRS 1 the following year (see CL 12 BP and CL 21 BDO). One respondent (CL 11 NASB) mentions in addition, that an unintentionally missing statement of compliance with IFRSs is an error: consequently, it should be corrected in accordance with the guidance in IAS 8.

34. Consequently, they are asking the Board to revise the wording of the proposed amendment.

Staff analysis and recommendation on Issue 4

35. We think that it is unlikely that an entity would unintentionally omit an assertion of compliance with IFRSs in its financial statements and it is unlikely that the auditor of an entity would not notice this omission. If, however, an entity omits to assert compliance with IFRSs (as required by paragraph 16 in IAS 1 *Presentation of Financial Statements*) we agree that this would be considered an error in accordance with paragraph 41 of IAS 8 that should be addressed in accordance with paragraphs 42–48 in this Standard.

36. Paragraph 16 of IAS 1 is reproduced below (emphasis added):

> **16** **An entity whose financial statements comply with IFRSs shall make an explicit and unreserved statement of such compliance in the notes.** An entity shall not describe financial statements as complying with IFRSs unless they comply with all the requirements of IFRSs.

37. Paragraph 41 of IAS 8 is reproduced below (emphasis added):

> **41** **Errors can arise in respect of** the recognition, measurement, presentation **or disclosure** of elements of financial statements. Financial statements do not comply with IFRSs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are authorised for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

38. In addition, we think that it is unlikely that an entity would intentionally omit the statement of compliance with IFRSs in order to obtain benefits through the application of the exemptions provided by IFRS 1 the following year, because the entity should explain to users why it is applying IFRS 1. In other words, we think that the costs of omitting the statement of compliance (ie the damage to the entity’s reputation) outweigh the benefits (ie being granted exemptions as provided by IFRS 1).

39. We also note that that our recommended disclosure (Issue 1) would discourage the intentional omission of the statement of compliance with IFRSs. As a

consequence, we think that the Committee should not revise the wording of the proposed amendment in order to address the comments raised by respondents.

Transition and effective date

40. Respondents did not raise any concerns with the proposed transitional provisions and effective date for the issue described in this paper.

Summary of staff recommendation and questions to the Interpretations Committee

41. We think that the Committee should recommend the Board that is should proceed with the proposed amendment but with the variations that we set out below. We think that the Committee should recommend to the Board that it should:

    (a) allow, rather than require, the repeated application of IFRS 1; and

    (b) require entities that have applied IFRS 1 previously to disclose:

        (i) the reason why the entity stopped applying IFRSs; and

        (ii) the reason why it is resuming reporting in accordance with IFRSs.

42. Our recommended changes to the draft wording are included as appendices:

    (a) **Appendix A** shows the proposed amendment, including our recommendations in this paper, highlighting differences from the currently effective standard; and

    (b) **Appendix B** shows revisions to the wording in the previously published exposure draft, following our recommendations in this paper.

Questions – Repeated application of IFRS 1
1. Does the Committee agree to recommend to the Board that it should proceed with the proposed amendment and that for entities that have applied IFRS 1 in a previous reporting period it should: (a) allow, rather than require, the repeated application of IFRS 1?; and (b) require a disclosure for the reasons why it stopped applying IFRSs and resume reporting in accordance with IFRSs? 2. Does the Committee agree with the proposed amendment in Appendix A? If not, what does the Committee recommend, and why?

Appendix A—Draft wording of the proposed amendment, showing differences from the currently effective standard

Proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

The heading before paragraph 2A, paragraphs 2A, 23A and 39M, are added.

Scope

2A If an entity has applied IFRS 1 in a previous reporting period, the entity may apply this IFRS when the entity's most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with IFRSs. If the entity does not elect to apply IFRS 1, it should apply IFRSs retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Estimates and Errors* as if the entity had never stopped applying IFRSs.

Presentation and disclosure

Explanation of transition to IFRSs

23A When an entity, in accordance with paragraph 2A, elects to apply IFRS 1 the entity shall disclose:

(a) the reason why it stopped applying IFRSs; and

(b) the reason why it is resuming reporting in accordance with IFRSs.

Effective date

39M *Improvements to IFRSs* issued in [date] added paragraph 2A and 23A and amended paragraph D23. An entity shall apply those amendments for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments

Paragraphs BC6A-BC6C are added.

BC6A The Board identified the need to clarify whether an entity may apply IFRS 1 again in its IFRS financial statements if the entity meets the criteria for applying IFRS 1 and has applied IFRS 1 in a previous reporting period. For example, an entity may have applied IFRS 1 in a previous reporting period to meet listing requirements in a foreign jurisdiction. The entity then delists and no longer presents financial statements in accordance with IFRSs. In a subsequent reporting period, the reporting requirements in the entity's local jurisdiction may change from national GAAP to IFRSs. Consequently, the entity is again required to present its financial statements in accordance with IFRSs.

BC6B The Board decided to clarify that an entity that meets the criteria for applying IFRS 1 and that has applied IFRS 1 in a previous reporting period, may choose to apply IFRS 1 when the entity's most recent previous annual financial statements do not contain an explicit and unreserved statement of compliance with IFRSs. The Board decided that the entity should be allowed, rather than required, to apply IFRS 1 because, as explained in paragraph IN5 of IFRS 1, IFRS 1 grants exemptions for some requirements of IFRSs on the assumption that the cost of complying with some IFRSs would be likely to exceed the benefits to users of financial statements. Consequently, the Board thinks that if an entity determines that the benefits of continuing to apply IFRSs as if it had continued to do so without interruption would exceed the costs of preparing such information, the entity should not be prohibited from following that continuation approach. The Board also noted that an entity that has never applied IFRSs in the past would continue to be required to apply IFRS 1 in its first IFRS financial statements.

BC6C The Board also decided that the entity shall disclose the reason why it stopped applying IFRSs and the reason why it is resuming reporting in accordance with IFRSs. The Board thinks that this disclosure requirement provides users with useful information and would discourage the intentional omission of the statement of compliance with IFRSs.

Appendix B—Draft wording showing changes from the exposure draft published in June 2011 following our recommendations in this paper

Proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

The heading before paragraph 2A, paragraphs 2A, 23A and 39M, are added (for ease of reference new text is underlined and deleted text is struck through).

Scope

2A If an entity has applied IFRS 1 in a previous reporting period, the ~~An~~ entity may ~~shall~~ apply this IFRS when the entity's most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with IFRSs.~~, even if the entity applied this IFRS in a reporting period before the period reported in the most recent previous annual financial statements.~~ If the entity does not elect to apply IFRS 1, it should apply IFRSs retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Estimates and Errors* as if as if the entity had never stopped applying IFRSs.

Presentation and disclosure

Explanation of transition to IFRSs

23A When an entity, in accordance with paragraph 2A, elects to apply IFRS 1 the entity shall disclose:

(a) the reason why it stopped applying IFRSs; and

(b) the reason why it is resuming reporting in accordance with IFRSs.

Effective date

39M *Improvements to IFRSs* issued in [date] added paragraph 2A and 23A and amended paragraph D23. An entity shall apply those amendments for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Paragraphs BC6A-BC6C~~D~~ are added.

BC~~1~~6A The Board identified the need to clarify whether an entity may ~~is required to~~ apply IFRS 1 again in its IFRS financial statements if the entity meets the criteria for applying IFRS 1 and has applied IFRS 1 in a previous reporting period. For example, an entity may have applied IFRS 1 in a previous reporting period to meet listing requirements in a foreign jurisdiction. The entity then delists and no longer presents financial statements in accordance with IFRSs. In a subsequent reporting period, the reporting requirements in the entity's local jurisdiction may change from national GAAP to IFRSs. Consequently, the entity is again required to present its financial statements in accordance with IFRSs.

~~BC2 The Board noted that the scope of IFRS 1 focuses on whether an entity's financial statements are its first IFRS financial statements. If an entity's financial statements are its first IFRS financial statements, the entity is required to apply IFRS 1 in accordance with paragraph 2(a).~~

~~BC3 However, use of the term 'first' raises the question whether IFRS 1 can be applied more than once when, after previously applying IFRS 1, an entity's most recent previous annual financial statements do not include an explicit and unreserved statement of compliance with IFRSs.~~

BC~~4~~6B The Board decided ~~proposes~~ to clarify that an entity that meets the criteria for applying IFRS 1 and that has applied IFRS 1 in a previous reporting period may ~~is required to~~ choose to apply IFRS 1 when the entity's most recent previous annual financial statements do not contain an explicit and unreserved statement of compliance with IFRSs. ~~even if the entity has applied IFRS 1 in a reporting period before the period reported in the most recent previous annual financial statements~~ The Board decided that the entity should be allowed, rather than required, to apply IFRS 1 because, as explained in paragraph IN5 of IFRS 1, IFRS 1 grants exemptions for some requirements of IFRSs on the assumption that the cost of complying with some IFRSs would be likely to exceed the benefits to users of financial statements. Consequently, the Board thinks that if an entity determines that the benefits of continuing to apply IFRSs as if it had continued to do so without interruption would exceed the costs of preparing such information, the entity should not be prohibited from following that continuation approach. The Board also noted that an entity that has never applied IFRSs in the past would continue to be required to apply IFRS 1 in its first IFRS financial statements.

BC6C The Board also decided that the entity shall disclose the reason why it stopped applying IFRSs and the reason why it is resuming reporting in accordance with IFRSs. The Board thinks that this disclosure requirement provides users with useful information and would discourage the intentional omission of the statement of compliance with IFRSs.