STAFF PAPER

May 2012

IFRS Interpretations Committee Meeting

Project	**New items for initial consideration**
Paper topic	Meaning of effective IFRSs

CONTACT(S) Daehyun Kim dkim@ifrs.org +44 (0)20 7246 6493

Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to address an issue related to the meaning of 'effective' in paragraph 7 of IFRS 1. The submitter notes that, if there is a new IFRS that is not yet mandatory but that can be adopted early, there may be two possible versions of an IFRS that are effective at the end of an entity's first IFRS reporting period. Consequently, an entity may:

   (a) have the choice between applying an old IFRS or adopting a new IFRS;

   (b) be required to apply the new IFRS only; or

   (c) be required to apply the old IFRS only.

2. This question has arisen because of a perceived discrepancy between paragraphs 7 and BC11 of IFRS 1.

3. Paragraph 7 states [emphasis added]:

   > 7 An entity shall use the same accounting policies in its opening IFRS statement of financial position and throughout all periods presented in its first IFRS financial statements. Those accounting policies shall comply with each IFRS **effective** at the end of its first IFRS reporting period, except as specified in paragraphs 13–19 and Appendices B–E.

This would imply that the entity has a choice between using a current version of an IFRS or adopting a new version early (where permitted to do so).

4. Paragraph BC11 states [emphasis added]:

> BC11 Paragraphs 7–9 of the IFRS require a first-time adopter to apply the **current** version of IFRSs, **without considering superseded or amended versions**. This:
>
> (a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;
>
> (b) gives users comparative information prepared using later versions of IFRSs that the Board regards as superior to superseded versions; and
>
> (c) avoids unnecessary costs.

This would imply that the entity should use the new version of the IFRS, and goes on to explain why this is recommended.

4. This submitter therefore requests clarification of the meaning of the word ‘effective’ as used in paragraph 7 of IFRS 1.

Purpose of this paper

5. This paper:

   (a) provides further background information on the issue (paragraphs 6–9);

   (b) includes the staff analysis and recommendation to clarify a basis for conclusion of IFRS 1 (paragraphs 10–15);

   (d) assesses the Annual Improvements criteria and the agenda criteria (paragraphs 16–17); and

   (e) asks the Committee for their views and comments on the staff recommendation.

Background information

6. The Oxford English Dictionary defines ‘effective’ as:

> “… successful in producing a desired or intended result;
> (especially of a law or policy) operative.”

If a new IFRS is not yet mandatory but is available for early adoption, we can say that an old version and a new version could be operative at the same time. Consequently, there might be two different versions of an IFRS that are effective at the end of its first IFRS reporting period.

7. When early application of an IFRS is permitted, it could be argued that the new IFRS is effective at an earlier date only if the entity chooses to exercise its right to apply it earlier. In the absence of the choice of early adoption, the new IFRS becomes effective only on its effective date.

8. According to paragraph BC11 of IFRS 1, however, later versions of IFRSs are regarded as superior to superseded versions. This is because applying the newer IFRSs can enhance comparability in a first-time adopter’s financial statements over time and reduce the conversion costs of an accounting system that would otherwise be incurred if the new IFRS is not applied until a later date. This view assumes that “current version of IFRSs” means a new version of IFRSs. This interpretation seems to match the reasons provided in paragraph BC11.

9. Consequently, interested parties have raised the inconsistency of the meaning of “effective IFRSs” in paragraphs 7 and BC11 of IFRS 1 as an issue.

Staff analysis

10. We think that paragraph 8 of IFRS 1 and its example make the case clear. Paragraph 8 states that an entity “may apply a new IFRS”, and its example illustrates that if a new IFRS is not yet mandatory but permits early application, Entity A is permitted, but not required, to apply that IFRS in its first IFRS financial statements.

11. Accordingly, we think that the principle in IFRS 1 is to apply the old version that is still effective. If a new IFRS is not yet mandatory but permits early application, that IFRS is permitted, but not required, to be applied.

12. In setting out reasons for applying the current or new version of the IFRS, instead of retaining the older version, paragraph BC11 appears to conflict with paragraph 7.

Staff recommendation

13. We think that the requirement in paragraph 7 is clear, but paragraph BC11 needs clarification to alleviate unnecessary misunderstanding. We propose a draft revision to the Basis for Conclusions, as provided in Appendix A to this paper.

14. Although paragraph BC11 could be revised, adding a new paragraph in the Basis for Conclusions is preferable to making a change to an existing paragraph because the Basis for Conclusions describes the rationale of the Board's decision at the time at which that decision was made.

15. Given the below assessment on the Annual Improvements criteria and the agenda criteria, we think that the Committee should recommend to the Board that it clarifies the meaning of 'effective' IFRSs and that the amendment should be included in the next Annual Improvements cycle.

Annual improvements criteria assessment

16. In planning whether an issue should be addressed by amending IFRSs within the Annual Improvements project, the Board assesses the issue against certain criteria. All the criteria (a)–(d) must be met to qualify for inclusion in annual improvements. We have assessed the potential amendment against the annual improvements criteria, which are reproduced in full below:

Annual improvements criteria	Staff assessment of the proposed amendment
(a) The proposed amendment has one or both of the following characteristics:	(a) Yes.

(i) clarifying—the proposed amendment would improve IFRSs by: • clarifying unclear wording in existing IFRSs, or • providing guidance where an absence of guidance is causing concern. A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle. (ii) correcting—the proposed amendment would improve IFRSs by: • resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirements should be applied, or • addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. A correcting amendment does not propose a new principle or a change to an existing principle, but may create an exception from an existing principle.	The proposed amendment clarifies a meaning of 'effective' IFRSs at the end of the first IFRS reporting period. This amendment also resolves a conflict between the existing requirements of IFRS 1 and its Basis for Conclusions
(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.	(b) Yes. The issue is sufficiently narrow in scope to ensure that the proposed amendment has been considered sufficiently and identified.
(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	(c) Yes. We think that the Board will reach a conclusion on this issue on a timely basis, because it is a clarification on a meaning of a word in requirements.
(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.	(d) Yes. There are no current projects on IFRS 1.

Agenda criteria assessment

17. The staff's preliminary assessment of the agenda criteria is as follows:

    (a) The issue is widespread and has practical relevance.

Yes, the issue arises from practice and the staff is in sympathy with the issue.

(b) *The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). An item will not be added to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.*

The issue indicates that there are divergent interpretations of the meaning of 'effective' in IFRS 1.

(c) *Financial reporting would be improved through elimination of the diverse reporting methods.*

Yes.

(d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Conceptual Framework, and the demands of the interpretation process. The issue should be sufficiently narrow in scope to be capable of interpretation, but not so narrow that it is not cost-effective for the Committee and its constituents to undertake the due process associated with an interpretation?*

Yes.

(e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

Yes, we think that the conclusion can be determined.

(f) *If the issue relates to a current or planned IASB project, there is a pressing to provide guidance sooner than would be expected from the IASB activities. The Committee will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the Committee requires to complete its due process.*

N/A. There are no planned or current IASB projects that the issue relates to.

Question to the Committee
Does the Committee agree with staff recommendation that additional background for conclusion should be added to clarify the Board's intention?

Appendix A—Proposed changes

A1. A new paragraph, BC11A is proposed to be added to the Basis for Conclusions to IFRS 1.

> BC11A Paragraph 7 requires that an entity shall use the IFRSs effective at the end of its first IFRS reporting period. Paragraph 8 allows a first-time adopter to apply a new IFRS that is not yet mandatory if that IFRS permits early adoption. Notwithstanding the advantages set out in paragraph BC11 of applying the latest version of an IFRS, paragraph BC11 does not restrict the choice permitted by paragraph 8 of an entity to use either the currently mandatory IFRS or the new IFRS that is not yet mandatory if that IFRS permits early application.