

Jörgen Holmquist
Director General
European Commission
Directorate General for the Internal Market
1049 Brussels

9 October 2009

Dear Mr. Holmquist

Adoption of the Amendments to IFRS 1 *Additional Exemptions for First-time Adopters*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, we are pleased to provide our opinion on the adoption of the Amendments to IFRS 1 *Additional Exemptions for First-time Adopters* (the Amendments), which were published in July 2009. The Amendments were proposed in an exposure draft on which EFRAG commented.

IFRS 1 provides guidance on the initial adoption of IFRS and, in doing so, provides a limited number of exemptions and exceptions as a practical solution for certain implementation issues that arise on first-time adoption. The Amendments introduce three new exemptions to existing IFRS for first-time adopters.

- One amendment provides for a new 'deemed cost' exemption for certain oil and gas assets.
- A second amendment is related to the first amendment and requires an entity that uses the deemed cost exemption to recognise directly in retained earnings any difference between the amount of decommissioning, restoration and similar liabilities as calculated under IFRS and the amount of the liability as calculated under the entity's previous GAAP.
- The third amendment provides an exemption from the requirement to carry out on transition to IFRS an IFRIC 4 assessment to determine whether the entity's arrangements contain leases if application an entity's previous GAAP would be expected to produce a similar result as IFRS.

The Amendments will apply for entities transitioning to IFRS for the first time for annual periods beginning on or after 1 January 2010.

EFRAG has carried out an evaluation of Amendments. As part of that process, EFRAG issued a draft assessment of the Amendments against the EU endorsement criteria for

*EFRAG Endorsement Advice Letter on Amendments to IFRS 1 -
Additional Exemptions for First-time Adopters*

public comment and, when finalising its advice and the content of this letter, took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports the Amendments and has concluded that they meet the requirements of Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that:

- they are not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
- they meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Amendments and, accordingly, EFRAG recommends their adoption. EFRAG's reasoning is explained in the attached 'Appendix – Basis for Conclusions'.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

**Appendix
Basis for Conclusions**

This appendix sets out the basis for the conclusions reached and for the recommendation made by EFRAG on the Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards: Additional Exemptions for First-time Adopters.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

- 1 The Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards: Additional Exemptions for First-time Adopters* (the Amendments) introduce three new exemptions to existing IFRS for first-time adopters. When evaluating the Amendments, EFRAG considered the following questions:
 - (a) Are the Amendments needed?
 - (b) Does the accounting that results from the application of the Amendments meet the criteria for EU endorsement?
- 2 Having formed tentative views on these issues and prepared a draft assessment, EFRAG issued that draft assessment on 7 September 2009 and asked for comments on it by 7 October 2009. EFRAG has considered all the comments received, and all were supportive of EFRAG's tentative conclusion that the Amendments met the EU endorsement criteria and EFRAG should recommend their endorsement.

Are the Amendments needed?

Deemed cost for oil and gas assets

- 3 The amendment, that allows entities transitioning to IFRS that use full cost accounting for their oil and gas assets to use deemed cost for those assets, is intended to provide relief in circumstances in which the information needed to determine IFRS cost is not available or, if the information is available, the costs to determine IFRS amounts are very high.
- 4 In such circumstances, under existing IFRS the entity is currently permitted to measure the assets at their transition date fair value. However, as the IASB explains in paragraph BC47B of the Amendments' Basis for Conclusions:

Determining the fair value of oil and gas assets is a complex process that begins with the difficult task of estimating the volume of reserves and resources. When the fair value amounts

*EFRAG Endorsement Advice Letter on Amendments to IFRS 1 -
Additional Exemptions for First-time Adopters*

must be audited, determining significant inputs to the estimates generally requires the use of qualified external experts. For entities with many oil and gas assets, the use of this fair value as deemed cost alternative would not meet the Board's stated intention of avoiding excessive cost (see paragraph BC41).

The IASB therefore concluded that it needed to amend IFRS 1 to introduce a third measurement basis to the options currently available.

- 5 In EFRAG's view, this third measurement basis might not be less costly than the existing fair value alternative but it is nevertheless needed to enable certain entities with oil and gas activities to transition to IFRS.

Decommissioning, restoration and similar liabilities

- 6 The amendment described above has consequences for the accounting treatment of changes in decommissioning, restoration and similar liabilities relating to oil and gas assets. Under existing IFRS, if those assets are accounted for on a cost basis, changes in related decommissioning, restoration and similar liabilities are accounted for by adjusting the asset's cost. However, if a first-time adopter is required to recognise a different amount of decommissioning, restoration and similar liabilities on transitioning to IFRS to the amount recognised immediately prior to transition, it cannot adjust that change to its liabilities against the asset's carrying amount if it also wishes to apply the deemed cost exemption (because the adjusted amount would not be deemed cost as defined).
- 7 EFRAG's assessment is that the IASB is correct in concluding that the result is that a consequential amendment needs to be made to the accounting treatment of changes in decommissioning, restoration and similar liabilities relating to oil and gas assets.

Reassessment of lease determination

- 8 The third amendment relates to the application of IFRIC 4 *Determining whether an Arrangement contains a Lease*. The IASB has identified a circumstance in which existing IFRS would require entities transitioning to IFRS to in effect re-apply the requirements they have been applying prior to IFRS, albeit with different 'as at' date. The IASB believes this could result in additional costs with no obvious benefits, and that an exemption is needed to prevent such a situation arising. EFRAG's assessment is that the IASB's analysis and conclusions are correct.

Does the accounting that results from the application of the Amendments meet the criteria for EU endorsement?

- 9 EFRAG has considered whether the Amendments meet the requirements of the European Parliament and of the Council on the application of international accounting standards, in other words that the Amendments:
- (a) are not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
 - (b) meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

*EFRAG Endorsement Advice Letter on Amendments to IFRS 1 -
Additional Exemptions for First-time Adopters*

EFRAG has also considered whether it is in the European interest to adopt the Amendments.

Comparability

- 10 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 11 Existing IFRS permits entities to use one of two measurement bases for their oil and gas assets when transitioning to IFRS. The deemed cost amendment introduces a third measurement basis (deemed cost) for certain types of assets. Having a third possible measurement basis might initially reduce comparability (between first-time adopters and between first-time adopters and entities that already apply IFRS). On the other hand, EFRAG believes the amendment will make it possible for more entities to adopt IFRS and, as more entities apply the same set of standards, the more comparable financial statements will become generally. Indeed, IFRS 1 in its entirety involves compromising of comparability in the short-term, but by doing so it enables more entities to adopt IFRS; thus resulting over time in greater comparability. Similarly, the other two amendments might initially reduce comparability to a degree, but they also make it possible for more entities to adopt IFRS and, as such, to achieve greater comparability in the long-term
- 12 As a result, EFRAG's overall assessment is that the Amendments meet the comparability criterion.

Relevance

- 13 According to the Framework, information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.
- 14 EFRAG considered whether the Amendments would result in the provision of relevant information; in other words, information that has predictive value, confirmatory value or both. EFRAG's assessment about the Amendments' relevance is very similar to its assessment of comparability; there might be a slight, short-term deterioration in relevance, but it will make it possible for more entities to adopt IFRS, which will result in an overall improvement in the relevance of the information provided. For that reason, EFRAG's overall assessment is that the Amendments meet the relevance criterion.

Reliability

- 15 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

*EFRAG Endorsement Advice Letter on Amendments to IFRS 1 -
Additional Exemptions for First-time Adopters*

- 16 The Amendments do not require any amounts to be estimated that are not being estimated currently under existing national requirements, which in the EU's case means national requirements that are in accordance with the EU Accounting Directives. In EFRAG's view, such amounts will not give rise to reliability concerns.

Understandability

- 17 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence. Although there are a number of aspects to the notion of 'understandability', EFRAG believes that most aspects are covered by the discussion above about relevance, reliability and comparability (because, for example, information that represents something as similar when it is in fact dissimilar is not comparable, and that lack of comparability will mean it is also not understandable). As a result, EFRAG believes that the main additional issue it needs to consider in assessing whether the information resulting from the application of the Amendments is understandable is whether that information will be unduly complex.
- 18 In EFRAG's view, the Amendments do not introduce any new complexities into the financial statements.

True and fair view

- 19 EFRAG has also concluded that there is no reason to believe that the information resulting from the application of the Amendments would be contrary to the true and fair view principle.

European interest

- 20 EFRAG is not aware of any reason to believe that it is in the European interest not to adopt the Amendments.

Conclusion

- 21 For the reasons set out above, EFRAG has concluded that the Amendments satisfy the criteria for EU endorsement and that EFRAG should recommend their endorsement.