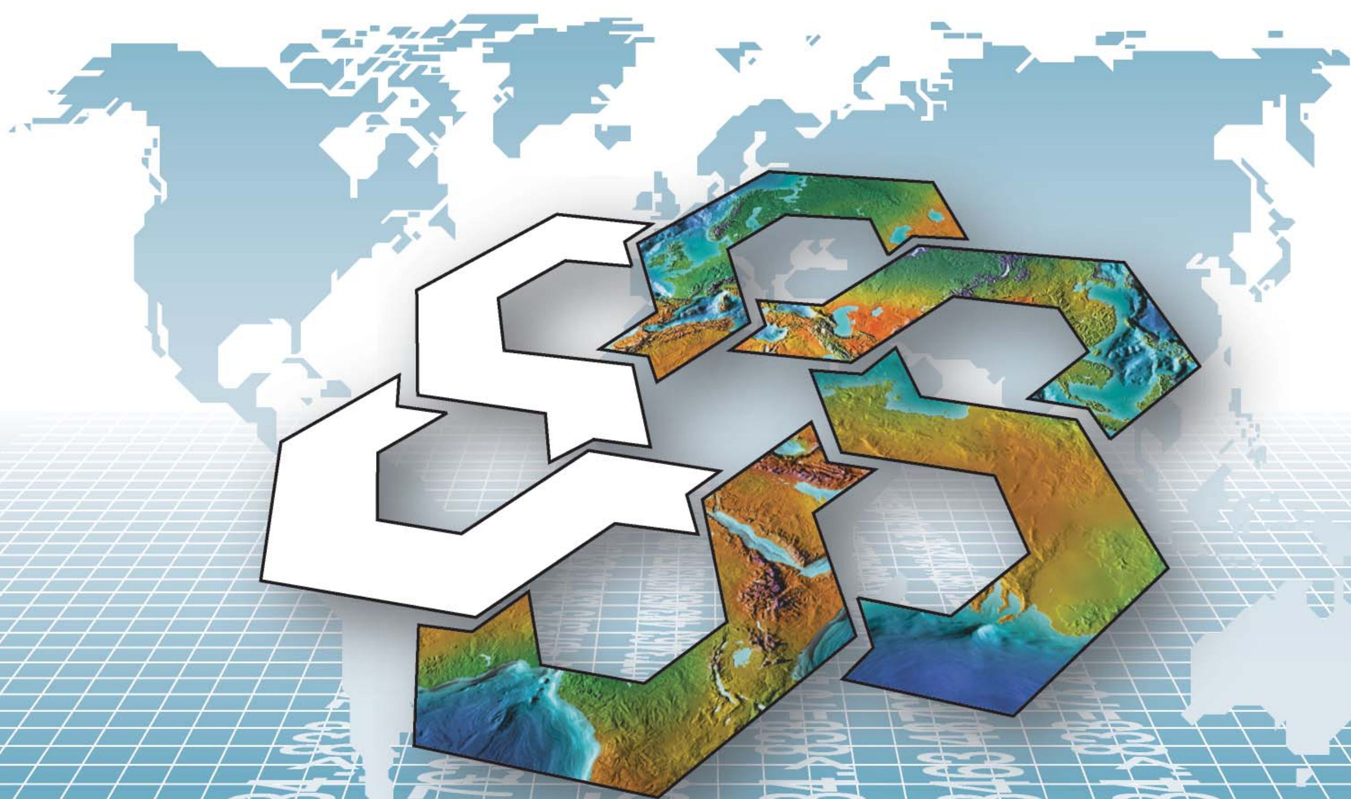
September 2008

EXPOSURE DRAFT

Additional Exemptions for First-time Adopters

Proposed amendments to IFRS 1

Comments to be received by 23 January 2009



International Accounting Standards Board®

Exposure Draft

ADDITIONAL EXEMPTIONS FOR FIRST-TIME ADOPTERS

(PROPOSED AMENDMENTS TO IFRS 1)

Comments to be received by 23 January 2009

This exposure draft *Additional Exemptions for First-time Adopters* (proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards)* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form as amendments to IFRS 1. Comments on the exposure draft and the Basis for Conclusions should be submitted in writing so as to be received by **23 January 2009.** Respondents are asked to send their comments electronically to the IASB Website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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Introduction and invitation to comment

In this exposure draft the International Accounting Standards Board proposes to amend IFRS 1 *First-time Adoption of International Financial Reporting Standards* to address potential challenges for jurisdictions adopting IFRSs in the near future.

The Board invites comments on any aspect of this exposure draft. It particularly welcomes answers to the questions set out below. Comments are most helpful if they:

(a) answer the question as stated,

(b) indicate the specific paragraph or paragraphs to which they relate,

(c) contain a clear rationale, and

(d) describe any alternative the Board should consider.

Respondents need not comment on all of the questions. The Board is not requesting comments on matters in IFRS 1 not addressed in this exposure draft.

The Board will consider all comments received in writing by **23 January 2009**. In considering the comments, the Board will base its conclusions on the merits of the arguments for or against each alternative, not on the number of responses supporting each alternative.

The Board plans to publish later this year a reformatted version of IFRS 1, based on proposals published in October 2007. The reformatting will not affect the substance of the proposals in this exposure draft, which shows the proposed changes to IFRS 1 in its existing format.

Question 1—Deemed cost for oil and gas assets

The exposure draft proposes that an entity that used full cost accounting under its previous GAAP may elect, at the date of transition to IFRSs, to measure exploration and evaluation assets at the amount determined under the entity's previous GAAP and to measure oil and gas assets in the development or production phases by allocating the amount determined under the entity's previous GAAP for those assets to the underlying assets pro rata using reserve volumes or reserve values as of that date.

Question 1

Do you agree with the proposed deemed cost option for entities using full cost accounting under previous GAAP? Why or why not? If not, what alternative do you propose and why?

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Question 2—Oil and gas assets—disclosure

The exposure draft proposes that if an entity uses the exemption described in Question 1 above, it must disclose that fact and the basis on which it allocated the carrying amounts to the underlying assets.

Question 2

Do you agree with the proposed disclosure requirements relating to the deemed cost option for oil and gas assets? Why or why not?

Question 3—Deemed cost for operations subject to rate regulation

The exposure draft proposes an exemption for an entity with operations subject to rate regulation. Such an entity could elect to use the carrying amount of items of property, plant and equipment held, or previously held, for use in such operations as their deemed cost at the date of transition to IFRSs if both retrospective restatement and using fair value as deemed cost are impracticable (as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).

Question 3

Do you agree with the proposed deemed cost option for entities with operations subject to rate regulation? Why or why not? If not, what alternative do you propose and why?

Question 4—Leases

The exposure draft proposes that if a first-time adopter made the same determination under previous GAAP as that required by IFRIC 4 *Determining whether an Arrangement contains a Lease* but at a date other than that required by IFRIC 4, the first-time adopter need not reassess that determination when it adopts IFRSs.

Question 4

Do you agree with the proposal not to require the reassessment of whether an arrangement contains a lease in the circumstances described in this exposure draft? Why or why not?

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Question 5—Assessments under previous GAAP before the date of transition to IFRSs

The Board considered whether to modify IFRS 1 so that entities need not reassess, at the date of transition to IFRSs, prior accounting if that prior accounting permitted the same prospective application as IFRSs with the only difference from IFRSs being the effective date from which that accounting was applied. In this regard, the Board noted that any such proposal must apply to *identical*, rather than *similar* accounting, because it would be too difficult to determine and enforce what constitutes a sufficient degree of similarity. The Board decided not to adopt such a modification because it concluded that the situation referred to in Question 4 is the only one in which relief of this type is needed.

Question 5

Do you agree that the situation referred to in Question 4 is the only one in which additional relief of this type is needed? If not, in what other situations is relief necessary and why?

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Proposed amendments to IFRS 1

Paragraphs 19A, 19B and 25EA, a heading and paragraphs 44B and 47M are added. Paragraph 13(b), a heading and paragraphs 25E and 25F are amended (new text is underlined and deleted text is struck through).

Recognition and measurement

Exemptions from other IFRSs

13 An entity may elect to use one or more of the following exemptions:

(a) ...

(b) ~~*fair value* or revaluation as~~ *deemed cost* (paragraphs 16–19B);

~~Fair value or revaluation as d~~ Deemed cost

19A A first-time adopter using full cost accounting[*] under previous GAAP may elect to measure oil and gas assets at the date of transition to IFRSs[†] on the following basis:

(a) exploration and evaluation assets at the amount determined under the entity's previous GAAP; and

(b) assets in the development or production phases at the amount determined under the entity's previous GAAP. The entity shall allocate this amount to the underlying assets pro rata using reserve volumes or reserve values as of that date.

The entity shall test exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition to IFRSs in accordance with IFRS 6 *Exploration for and Evaluation of Mineral Resources* or IAS 36 *Impairment of Assets* respectively and, if necessary, reduce the amount determined in accordance with (a) or (b) above. For the purposes of this paragraph, oil and gas assets comprise only those assets used in the exploration, evaluation, development or production of oil and gas.

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[*] Under full cost accounting, exploration and development costs for properties in development or in production are accounted for in cost centres that include all properties in a large geographical area.

[†] Note for exposure draft readers: Appendix A of IFRS 1 defines the 'date of transition to IFRSs' as: 'The beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements.'

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19B Some entities hold, or have previously held, items of property, plant and equipment for use in operations subject to rate regulation. The carrying amount of such items sometimes includes amounts that were determined under previous GAAP but do not qualify for capitalisation in accordance with IFRSs. If this is the case, a first-time adopter may elect to use the carrying amount of such an item at the date of transition to IFRSs if it is otherwise impracticable (as defined in IAS 8) to meet the requirements of this IFRS. An entity shall apply this election item by item. At the date of transition to IFRSs, an entity shall test each item for which this exemption is used for impairment in accordance with IAS 36 and, if necessary, reduce the carrying amount. For the purposes of this paragraph, operations are subject to rate regulation if they provide services or products to customers at prices (ie rates) established by legislation, an independent regulator or other authorised body that are designed to recover the cost of providing the services or products and allow the entity to earn a determined return on investment.

Changes in existing decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment

25E ...

(c) ... under IFRSs.

An entity that uses the exemption in paragraph 19B (for operations subject to rate regulation) uses the amount as determined in accordance with that paragraph as the depreciable amount to be adjusted as a result of this paragraph.

25EA An entity that uses the exemption in paragraph 19A(b) (for oil and gas assets in the development or production phases accounted for using full cost accounting under previous GAAP) shall, instead of applying paragraph 25E or IFRIC 1:

(a) measure decommissioning, restoration and similar liabilities as at the date of transition to IFRSs in accordance with IAS 37; and

(b) recognise directly in retained earnings any difference between that amount and the carrying amount of those liabilities at the date of transition to IFRSs determined under the entity's previous GAAP.

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Leases

25F A first-time adopter may apply the transitional provisions in IFRIC 4 *Determining whether an Arrangement contains a Lease*. Therefore, a first-time adopter may determine whether an arrangement existing at the date of transition to IFRSs contains a lease on the basis of facts and circumstances existing at that date. If a first-time adopter made the same determination under previous GAAP as that required by IFRIC 4 but at a date other than that required by IFRIC 4, the first-time adopter need not reassess that determination at the date of transition to IFRSs.

Presentation and disclosure

Explanation of transition to IFRSs

Use of deemed cost for oil and gas assets

44B If an entity uses the exemption in paragraph 19A(b) for oil and gas assets, it shall disclose that fact and the basis on which carrying amounts determined under previous GAAP were allocated.

Effective date

47M An entity shall apply the amendments in paragraphs 13(b), 19A, 19B, 25E, 25F and 44B for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

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Appendix

Proposed amendment to the guidance on implementing IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph IG206 is added.

IFRIC 4 *Determining whether an Arrangement contains a Lease*

IG206 Paragraph 25F of IFRS 1 provides a transitional exemption in addition to that discussed in paragraph IG205. If an entity applied previous GAAP requiring a determination identical to that required by IFRIC 4 and that previous GAAP had transitional provisions identical to those in IFRIC 4 (the result being that the only difference in accounting is a different effective date from the one in the transitional provisions of IFRIC 4) that entity may elect to use the determination in accordance with the previous standard.

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Approval by the Board of *Additional Exemptions for First-time Adopters* (proposed amendments to IFRS 1) published in September 2008

Additional Exemptions for First-time Adopters (an exposure draft of proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*) was approved for publication by the thirteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Stephen Cooper	
Philippe Danjou	
Jan Engström	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
John T Smith	
Tatsumi Yamada	
Wei-Guo Zhang	

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Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the proposed amendments to IFRS 1.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in *Additional Exemptions for First-time Adopters* (an exposure draft of proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*) published in September 2008. Individual Board members gave greater weight to some factors than to others.

BC2 The Board developed the exposure draft after considering first-time adoption challenges likely to be faced in jurisdictions adopting IFRSs in the near future. This Basis for Conclusions discusses the following three proposals:

(a) oil and gas assets (paragraphs BC3–BC8);

(b) operations subject to rate regulation (paragraphs BC9–BC12); and

(c) leases (paragraphs BC13 and BC14).

Oil and gas assets

BC3 On first-time adoption of IFRSs, entities that used full cost accounting under their previous GAAP will in most cases have to determine the carrying amounts for oil and gas assets at the date of transition to IFRSs. Information about oil and gas assets recorded in an accounting system using full cost accounting will almost always be at a larger unit of account than the unit of account that is acceptable under IFRSs. Amortisation at the IFRS unit of account level would also have to be calculated (on a unit of production basis) for each year, using a reserves base that has changed over time because of changes in factors such as geological understanding and prices for oil and gas. In many cases, particularly for older assets, this information may not be available. The Board was advised that even if such information is available the effort and associated cost to develop the opening balances at the date of transition would usually be very high.

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BC4 IFRS 1 permits an entity to measure an item of property, plant and equipment at its fair value at the date of transition to IFRSs and to use that fair value as the item's deemed cost at that date. 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 included in the financial statements must be audited, significant inputs to the estimates generally require 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 IFRS 1 paragraph BC41).

BC5 The Board proposes that, for oil and gas assets in the development or production phases, it would permit entities that used full cost accounting under their previous GAAP to determine the deemed cost at the date of transition to IFRSs using an allocation of the amount determined under the entity's previous GAAP on the basis of the reserves associated with the oil and gas assets.

BC6 The deemed cost of oil and gas assets determined in this way may include amounts that would not have been capitalised in accordance with IFRSs, such as some overhead costs, costs that were incurred before the entity obtained legal rights to explore a specific area (and cannot be capitalised in accordance with IAS 38 *Intangible Assets*) and, most significantly, unsuccessful exploration costs that have been included in the full cost pool. This is a consequence of having included these costs in the single carrying amount under full cost accounting. To avoid the use of deemed costs resulting in an oil and gas asset being measured at more than its recoverable amount, the Board proposes that oil and gas assets should be tested for impairment at the date of transition to IFRSs.

BC7 Paragraph 25E of the IFRS exempts from the requirements of IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* changes in decommissioning costs incurred before the date of transition to IFRSs. Use of this exemption would require detailed calculations that would not be practicable. The Board noted that adjustments to liabilities as a result of initial adoption of IFRSs arise from events and transactions before the date of transition to IFRSs and are generally recognised in retained earnings. Therefore, the Board proposes that any adjustment for a difference between decommissioning, restoration and similar liabilities measured in accordance with IAS 37 and the liability determined under the entity's previous GAAP should be accounted for in the same manner.

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BC8 Not all oil and gas entities use the full cost method. Some use the successful efforts method. Successful efforts accounting requires a unit of account that is generally consistent with IFRSs and does not cause similar transition issues. Therefore, the Board proposes that this amendment to IFRS 1 would apply only to entities that used full cost accounting under their previous GAAP.

Operations subject to rate regulation

BC9 Under previous GAAP, an entity might have capitalised, as part of the carrying amount of items of property, plant and equipment held for use in operations subject to rate regulation, amounts that do not qualify for capitalisation under IFRSs. For example, when setting rates regulators often permit entities to capitalise, as part of the cost of property, plant and equipment acquired, constructed or produced over time, an allowance for the cost of financing the asset's acquisition, construction or production. This allowance typically includes an imputed cost of equity. The inclusion of an imputed cost of equity in property, plant and equipment is not in accordance with IAS 23 *Borrowing Costs* and IAS 16 *Property, Plant and Equipment*.

BC10 An entity might have items of property, plant and equipment that it holds for use in operations subject to rate regulation, or that it once used for this purpose and now holds for other purposes. To comply with IFRS 1 before the proposed amendments, an entity with such items whose carrying amounts include amounts that do not qualify for capitalisation under IFRSs must either restate those items retrospectively to remove the non-qualifying amounts, or use the exemption in paragraph 16 (fair value as deemed cost). Both of those alternatives are often impracticable.

BC11 Typically, once amounts are included in the total cost of an item of property, plant and equipment, they are no longer tracked separately. The restatement of property, plant and equipment to remove amounts not in compliance with IFRSs would require historical information that, given the typical age of some of the assets involved, is probably no longer available and would be difficult to estimate. Obtaining the fair value information necessary to use the exemption in paragraph 16 may also be impracticable, given the lack of readily available fair value information for those assets and the difficulty in valuing the required number of assets in such capital-intensive operations all at one time.

BC12 The Board views the proposed exemption as consistent with the exemptions already found in IFRS 1 in that it avoids excessive costs while meeting the objectives of the IFRS. The Board understands that most

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first-time adopters with operations subject to rate regulation have previously accounted for property, plant and equipment largely in accordance with the historical cost model of IAS 16. The Board concluded that the cost and effort required to achieve total compliance in this area for the purposes of preparing an entity's first IFRS financial statements is not warranted to meet the objective of providing a suitable starting point for accounting under IFRSs. The requirement to test each item for which the proposed exemption is used for impairment at the date of transition provides further assurance that this objective is met.

Leases

BC13 IFRIC 4 *Determining whether an Arrangement contains a Lease* permits an entity to apply its requirements to arrangements existing at the start of the earliest period for which comparative information is presented on the basis of facts and circumstances existing at the start of that period. Before adopting IFRSs, a jurisdiction might adopt a national standard identical to IFRIC 4, including the same transitional provisions. An entity in that jurisdiction might then apply requirements identical to those of IFRIC 4 at the start of the earliest period for which comparative information is presented in accordance with that national standard. However, on adopting IFRSs, IFRS 1 would require that entity to reassess that accounting retrospectively on first-time adoption. This might result in additional costs, with no benefits. Accordingly, the Board proposes that if a first-time adopter made the same determination under previous GAAP as that required by IFRIC 4 but at a date other than that required by IFRIC 4, the first-time adopter need not reassess that determination at the date of transition to IFRSs.

BC14 The Board considered a more general modification to IFRS 1. In particular, it considered whether to modify IFRS 1 so that entities need not reassess, at the date of transition to IFRSs, prior accounting if that prior accounting permitted the same prospective application as IFRSs with the only difference from IFRSs being the effective date from when that accounting was applied. In this regard, the Board noted that any such proposal must apply to *identical*, rather than *similar* accounting, because it would be too difficult to determine and enforce what constitutes a sufficient degree of similarity. The Board noted that many of the circumstances in which this situation might arise have been dealt with in IFRS 1 or other IFRSs. Accordingly, the Board proposes an exemption only for the situation discussed above regarding IFRIC 4.

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