31 January 2011

Our ref: ICAEW Rep 14/11

Your ref:

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Dear Sir David

REQUEST FOR VIEWS *EFFECTIVE DATES AND TRANSITION METHODS*

The ICAEW is pleased to respond to your request for comments on the IASB Request for views *Effective Dates and Transition Methods.*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

John Boulton ACA
Technical Manager, Financial Reporting Faculty

T +44 (0)20 7920 8642
E john.boulton@icaew.com

ICAEW REPRESENTATION

REQUEST FOR VIEWS *EFFECTIVE DATES AND TRANSITION METHODS*

Memorandum of comment submitted in July 2010 by the ICAEW, in response to the IASB's Request For Views *Effective Dates And Transition Methods* published in October 2010.

Contents	**Paragraph**

INTRODUCTION

1. The ICAEW welcomes the opportunity to comment on the consultation paper *Effective Dates and Transition Methods* published by the IASB.

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

MAJOR POINTS

We support a 'big bang' approach

4. The significant volume of changes to IFRS due to be released by June 2011 will represent a major challenge to users, preparers and auditors. By opting for a single date approach to mandatory adoption the Board can minimise the cost and disruption this will occasion. A single mandatory adoption date will reduce problems of comparability, particularly as change-over becomes a unified, single exercise for users and preparers. This reduces costs. A particular saving is achieved as some of the standards are complementary or interlinking and therefore without a single date focus some areas would risk successive, piecemeal change. This could, and should be avoided.

Adequate time must be allowed between issuance of standards and mandatory application

5. To further alleviate transition pressures, adequate time should be allowed before application becomes mandatory. For this reason, we would suggest a minimum three year period between issuance and effective date; presuming that the amended or new standards are all issued by June 2011, this implies an effective date in 2015. Not only does this allow users, preparers and auditors adequate time to absorb the new requirements and to assess their implications, it also gives those countries moving onto IFRS between 2010 and 2013 an appropriate period during which a 'stable platform' is in operation. This will ease their transition process.

Early adoption should be permitted

6. While we consider that there are benefits to a single mandatory adoption date, we also believe that early adoption should be allowed. This option is commonly given when a new standard is released and we see no reason why it should not be permitted this time. Early adoption allows those companies with fewer transition challenges to move-over without delay, this is to be encouraged where, as is to be hoped, the new standard is an improvement on current practice. Ultimately, we feel that the benefits to be gained from early adoption outweigh the costs arising from reduced comparability.

7. We do however suggest that early adoption of certain standards be linked with that of others. Leasing should not be permitted to be adopted unless revenue recognition is adopted at the same time or has previously been adopted, and Financial Instruments and Insurance should be adopted at the same time, as should Consolidation and Joint Arrangements.

Transitional provisions require revision for some of the more complex standards

8. In our comment letters to the various Exposure Drafts included in the scope of this consultation, we expressed a number of concerns about the transitional arrangements being proposed. We have repeated these concerns in paragraphs 17 - 31 below.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1. Please describe the entity (or the individual) responding to this Request for Views.

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).

9. ICAEW is a world leading professional accountancy body, providing leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. Our membership encompasses participants in all of the major constituency groups for IFRS; preparers, users, auditors, capital providers, etc.

10. The IASB's planned release of a range of new and amended standards in 2011 will require our members to undertake a considerable amount of work in assessing and responding to the changes. Some of the more significant changes include:
Interpreting and comparing financial information: Users will need to be able to assess the effect of the changes on the financial statements they are analysing particularly where these have the potential to vary between companies and therefore affect comparability. Preparers will wish to ensure that they are communicating adequately with users to facilitate this process. Other users, such as tax authorities and regulators will also need to assess the effect of the changes and ensure that their staff are trained in the new requirements.
Implementing system and process changes: Some of the changes to requirements may necessitate corresponding changes to the systems that gather and collate financial data; to business processes; or to contracts - for example where they reference the terms operating or finance lease. Companies will need to assess these factors and will need adequate time to implement the necessary changes
Education and training: Preparers, users and auditors will need to be trained in the new requirements. Existing educational material will need to be updated. Again, adequate time will be needed to ensure that this can be completed.
Understanding and anticipating changes in profit recognition patterns: Some of the changes are likely to involve considerable changes to profit recognition patterns, particularly those that involve revenue recognition or the accounting for insurance contracts. This will have a corresponding effect on the timing of tax payments and therefore may require companies to revisit business plans and redesign or re-price contracts. It may also be necessary to re-negotiate loan covenants or make other changes to financing agreements.

Q2. Focusing only on those projects included in the table in paragraph 18 above:

(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?

11. We believe the Board should opt for a 'big bang' approach and therefore propose a common effective date for all of the standards planned to be issued by June 2011, with a three year period between issuance and effective date. We do believe that adoption of some of the standards (leasing, financial instruments, or insurance for example), will entail significantly more effort and cost than others. However, we do not believe that this amounts to a case for decoupling some, less complex, standards and requiring adoption of these to an accelerated timetable. Such an approach could lead to a significant period of time during which financial statements were in constant flux, and moreover were probably restated each period. Furthermore, there are many inter-relationships between the Standards being changed, causing a combined effect on transactions. A big-bang approach would allow adoption to be approached holistically and thereby bring into effect the different strands of the various inter-relationships simultaneously. This is likely to ease both implementation, and analysis of the resulting financial statements.

(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?

12. We have listed in the answer to question 1 above the four main cost groups that we believe the Board should be aware of. Their relative significance will differ between constituency groups; users are likely to be most sensitive to the extra effort required in interpreting and comparing financial information; preparers may be most concerned about the system and process changes necessary and how management information and commercial agreements will be affected; all groups are likely to find the training requirements onerous.

Q3. 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?

13. Yes; clearly some of the proposed changes, if adopted as exposed, will have knock-on implications for other regulatory or tax requirements. In some cases the implications may be far-reaching. One example is provided by leasing; UK tax legislation contains over 100 references to operating or finance leases and therefore changes would be necessary were the exposed draft standard on leasing to be adopted. Given the ability of companies to early adopt, an immediate reaction from some authorities may be necessary, although this may be no more than an interim measure in many cases while a permanent solution is worked-up.

14. In addition, Auditing Standards and related Guidance material will require review to ensure that they adequately deal with the many new areas of judgment that the new Standards introduce. We suggest that the IASB engage with the IAASB to determine any concerns they may have.

15. Any change to expected loss provisioning will have implications for regulatory capital requirements; this is a well known area of concern for regulators who will need to work through all the financial instrument changes and consider the impact on their requirements. Distributable profits guidance will also need to be reviewed. There could be consequences for debt covenants, and possibly to other contracts as well. And finally preparers will need to consider the tax consequences of any changes they make.

16. Not only will the necessary authorities need time to assess, respond to and implement mitigating measures, but companies will need to devise their own responses to the measures the authorities put into place. This highlights the need to ensure that adequate time is allowed for the necessary actions to take place. To this end we would suggest that the effective date for this group of standards should be set at three years after issuance, which would imply a date in 2015.

Q4. 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.

17. We have responded to each of the Exposure Drafts that are the subject of this consultation. In these responses we have set out a number of concerns with the proposed transitional arrangements, which are set-out below. We urge the Board to evaluate these concerns and to draw up a consistent approach to transition that takes them into account: In addition, the Board should consider overall requirements (along the lines of IFRS 1 paragraph 22) for historical summaries that may be produced under the previous versions of IFRS.

Financial Instruments

18. The transition to IFRS 9 will be complex because the different aspects may require different transition reliefs or even completely different approaches because, for example, hedge accounting is not applied retrospectively. The difficulty of thinking through the transition is increased since not all the proposals are finalised and the IFRS 9 transition that exists at present is based on allowing a phased approach with classification and measurement able to be applied from November 2009. Regardless of whether the approach is amended or not, it would be helpful for the final IFRS 9 that incorporates all phases to have a more coherent approach to transition as at a single date. This would be consistent with our view of a single big bang three years after all the standards are available in their final form.

19. The existing transition requirements for classification and measurement of financial assets work differently to a full retrospective application. This is because the classification is meant to be determined as at the date of the opening balance sheet of the current reporting period (based on facts and circumstances at that time) and then this classification is applied (with some modifications) to the opening balance sheet for the first comparative period presented. As a result, the IFRS 9 classifications cannot be applied to financial assets that did not exist at this date of initial application but that are needed to be included in the comparative financial statements. These financial assets continue to be accounted for under IAS 39. As a result the opening balance sheet for the earliest comparative period presented will include a mix of financial assets under both IFRS 9 and IAS 39. This results in practical difficulties in separating the comparative balance sheets into assets that exist at the date of transition and those that do not. The practical difficulties are likely to become greater the further back in time the first opening balance sheet must be prepared. For example assuming an application in January 2015, under IAS 1 (revised) a balance sheet as at 1 January 2014 would be needed. Some entities may be required to produce three or five years of comparatives in which case, the first opening balance sheet would be 1 January 2013 or even 2011. Tracking the existence of assets across open portfolios for five years could be a considerable task. Making constructive use of comparatives that contain a mix of different classification and measurement requirements for financial instruments, is also a challenge and raises the risk that the comparatives could be misleading. If the existing transition requirements remain unchanged, the Board should consider putting some limit to number of financial years that are restated..

20. ,Even with a limit on restatements, we are not convinced of the value to users of comparatives that include a mix of financial assets under IFRS 9 and IAS 39, particularly coupled with some of the other potential exceptions to retrospective application such as using the fair value of financial assets as a proxy for amortised cost in the comparative periods.

21. An alterative would be to require classification and measurement as at the date of the opening balance sheet of the earliest comparative period presented. Such an approach would allow for more meaningful comparatives, particularly as business models are not expected to change on a regular basis. However, the approach has its drawbacks in that it may require an inappropriate amount of hindsight.

22. We suggest that the IASB should discuss the transition to IFRS 9 with any companies (and their analysts) that have applied the existing standard. Further outreach with users may be helpful in determining how they would interpret comparatives that were not, in fact, comparable. An analysis of the research into the initial transition to IFRS in Europe may also be helpful. It is our understanding that users were generally content with the information they received under IFRS 1 even though comparatives were not required for IAS 39. If the costs of producing comparatives are likely to exceed the benefit to users, there would be strong arguments for an initial application of IFRS 9 by restating and explaining the opening balance sheet as at the date of transition but not restating comparative periods. While the impairment proposals are not yet final, we have previously expressed concerns about the practical difficulties of applying them retrospectively. Hedge accounting is, by its nature, prospective. It may be that an approach based on the IFRS 1 transition for IAS 39 would provide users with more understandable information at a more reasonable cost.

Insurance Contracts

23. We disagree with the proposals for transition. They are inconsistent with the treatment of residual margin on new business and would provide results similar to that of a start-up operation which is not an appropriate reflection of the economic reality.

24. Where it is practicable, we favour full retrospective application. Entities using the premium allocation approach should certainly be able to adopt full retrospective application for their pre-claims liabilities, as the insurer will be able to rely on the existing systems to generate the unearned premium reserve to be brought forward at the date of transition.

25. However, we recognise that for many entities it would be impracticable to do this and even where possible, the costs of calculating the retrospective adjustment would be prohibitive. In our view, alternative proposals on transition should be developed. These might require a partial retrospective approach that sets out some acceptable methods and approaches to achieving this partial application (for example using some current information).

26. It is likely that the old and new book of business may need to be shown separately. This would certainly be the case if the current proposals are taken forward (which we do not advocate), and may also be the case if an improved approach were to be developed.

Leases

27. We agree that mandatory full retrospective application would be too onerous in many cases and therefore agree that some simplified transitional arrangements are necessary. However, we are not convinced that what the boards are proposing is a suitable solution.

28. We share the concerns raised in the alternative view; the proposed approach will lead to a misleading reduction in lessees' profits on transition and increased profit growth in subsequent periods with the opposite effect for lessors. In common with the alternative view, we believe other transitional provisions should be considered for both lessees and lessors. Full retrospective application should be permitted or the transitional provisions adjusted so that the right-of-use asset is not necessarily set equal to the transition liability, but instead takes account of the impact of the remaining lease term compared to the original lease period.

Post-employment benefits

29. We agree that the requirements should be applied retrospectively. In most cases the information necessary to apply the new requirements should be accessible relatively easily; therefore we see no reason why the normal IAS 8 approach of retrospective application should not be required.

Revenue from contracts with customers

30. We agree that the requirements should apply retrospectively, otherwise comparability will be impaired during the transition period. However, the practicality of retrospective application will depend upon the profile of contracts that a company has. For those companies with contracts that span several years, the re-examination of these contracts to determine the effects of adoption is likely to be an extensive exercise. Therefore we would welcome an extension of paragraph 85 of the revenue recognition Exposure Draft, acknowledging that significant estimation may sometimes be required in full retrospective application, that this is acceptable and that, where it is significant companies should disclose the approach they have taken in determining the retrospective amounts.

31. It should also be noted that the burden of transition may be greater for smaller companies who may lack the sophisticated systems and other resources necessary to provide the necessary information. Therefore, as and when the requirements are incorporated within the IFRS for SMEs it may be desirable to offer a longer transition period than that provided in the new IFRS on revenue recognition.

Q5. 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).

32. We would prefer the single date approach. Adoption of the new standards will cause significant changes to the financial statements. Far better for users that these be concentrated into a single year such that effort to interpret the effect of the changes can be focused on that year. Staggering effective dates over a number of years would spread disruption over a longer period, thereby rendering it more difficult to contain this disruption. Comparability would become very difficult to achieve and the effect of this would be compounded by repeated restatements where these were required on adoption. Provided the implementation period is sufficiently long to allow it, a single date approach will be cheaper because the restatement becomes a single effort for preparers and users. It also avoids the accounting being changed twice where a transaction is affected by more than one Standard coming into force on different dates.

(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?

33. We believe that a minimum three year period is necessary between issuance and the effective date. Therefore, assuming the standards listed in the request for views are all released by June 2011, the earliest effective date that should be considered would be 2015. Preparers, users and auditors will need an adequate period of time to assess the effect of the changes, and to implement any measures that will be necessary in addressing them. By choosing 2015 this would also allow a stable platform for a period following the adoption of IFRS by Canada, Brazil, Argentina, Mexico, South Korea, and the permitting of IFRS use by Japan.

34. Furthermore, from a European perspective, the new standards will need to be endorsed before they can be adopted for use in the EU. The endorsement process may not be completed by the end of 2011; indeed for those elements of IFRS 9 *Financial Instruments* that have already been released, the endorsement process is still not complete. This is therefore another reason why sufficient time should be allowed between issuance and effective date.

(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.

35. We do not support the sequential approach.

(d) Do you think another approach would be viable and preferable? If so, please describe that approach and its advantages.

36. No. We believe the single-date approach to be the most operable option.

Q6. 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)?

37. Yes, we believe that early adoption should be permitted. In our experience it has been usual practice for early adoption to be allowed. Some companies will have lesser implementation difficulties than others, and these should not be prevented from moving to the new Standards early, particularly as these are seen by the IASB as an improvement on existing practice. Whilst in theory comparability could be compromised, in practice whole industries tend to move together as their composite companies each wish to remain in the mainstream and the implementation challenges they face are likely to be lighter on collective adoption. Overall we feel that the benefits to be gained from permitting early adoption outweigh the costs.

38. Consistent with our observations made in paragraph 10 above, we believe that the boards should carefully consider the interactions between different standards, and whether early adoption of one new standard would practically require early adoption of another. In our view, leasing should not be permitted to be adopted unless revenue recognition is adopted at the same time or has previously been adopted, and Financial Instruments and Insurance should be adopted at the same time, as should Consolidation and Joint Arrangements.

Q7. 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?

39. Yes, if at all possible the two Boards should agree on consistent adoption arrangements. Comparability is impaired where the two differ and we see no reason why this situation should be allowed to arise if it can reasonably be averted. However, we do strongly feel that the first duty of the IASB is toward IFRS users and that their interests should be its primary consideration.

40. We have noted above that we would prefer a somewhat delayed effective date in the interests of allowing adequate time to adapt to change, and furthermore that we would prefer a big-bang transition. Both of these factors should make an accommodation with the FASB more achievable, deferral as it opens a bigger time window for agreement as well as accommodating the longer application period under US GAAP, big bang as it simplifies the process.

Q8. 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?

41. No. We do agree that there is merit in maintaining a stable platform for those countries adopting IFRS between 2010 and 2013. Our suggestion above that the earliest effective date the Board should consider would be 2015 (assuming all the new standards are issued by June 2011), would allow for a stable platform of two years for these jurisdictions. Allowing early adoption in this context is an added benefit as this would permit (but not require) companies in these countries to move straight onto the new standards if they so wished.

42. However, it may be that IFRS 1 needs to be revised to address transition for those who are adopting some or all of the revised standards in their first IFRS financial statements, in order to facilitate the practical ability of first-time adopters to early adopt the revised standards before the mandatory adoption date.

E john.boulton@icaew.com