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# First-time adoption of International Financial Reporting Standards

## A guide to IFRS 1

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# Foreword

For most users of financial statements, the term 'IFRSs' is quite familiar: International Financial Reporting Standards have been the subject of global news headlines for several years now. The spotlight first shone on IFRSs in 2001, when the European Commission announced that all entities listed on European stock exchanges would be required to adopt IFRSs by 2005. Since then, IFRSs have attracted attention on a regular basis including, more recently, as part of the discussion of the role of accounting standards in the current global financial crisis.

The movement of more and more jurisdictions towards a single, globally accepted, high quality set of accounting standards is proceeding at a welcome pace. IFRSs are now in use for public reporting purposes in over 100 countries, including both developed and emerging economies. We are now firmly in the 'second wave' of adoption, as other large countries such as Chile, Korea, India, Brazil and Canada have all announced plans to adopt IFRSs in the near future. The signs are promising that the United States will also join this list – although a formal date for adoption has not been announced, we are encouraged by the dialogue between the SEC and constituents, as well as the IASB and the FASB's continued joint projects and progress towards convergence.

This guide to IFRS 1 *First-time Adoption of International Financial Reporting Standards* was first published in 2004 with the aim of providing first-time adopters with helpful insights for the application of IFRS 1. We are releasing this second edition with the same objective – having updated the content to reflect the lessons learned from the first major wave of IFRS adoption in 2005, as well as for the changes to IFRS 1 since 2004.

We have structured the guide so as to provide users with an accessible reference manual:

- our **executive summary** explains the most important features of IFRS 1;
- **section 2** provides an overview of the requirements of the Standard;
- **sections 3 and 4** cover the specific exceptions and exemptions from IFRS 1's general principle of retrospective application of IFRSs, focusing on key implementation issues;
- **section 5** addresses other components of financial statements where implementation issues frequently arise in practice;
- **section 6** sets out Q&As dealing with specific fact patterns that users may encounter in practice; and
- **section 7** discusses some of the practical implementation decisions faced by first-time adopters.

The matters addressed in this guide are intended to supplement the IASB's own guidance and act as an educational tool for the reader. However, this publication does not contemplate or address all possible fact patterns or industry-specific issues; therefore, it should not be considered a definitive guide on all matters related to first-time adoption. Readers are encouraged to consult with a Deloitte professional to further discuss any specific issues, questions or concerns.

We hope that you will find this guide a useful tool in applying IFRS 1. It is important to remember that IFRS 1 is not a static Standard. It was introduced to address the very real need to ease the burdens (both cost and effort) of transition for first-time adopters. As has been the case in the past, as more entities move towards adopting IFRSs, it is possible that additional areas will be identified where the costs of application of IFRSs on first-time adoption exceed the benefits, in which case the IASB may introduce additional exemptions. Furthermore, as IFRSs continue to evolve, consequential amendments to IFRS 1 will be required. To keep up to date on further developments in IFRS 1 as you move through your transition journey, or to learn more about IFRSs in general, we encourage you to visit our website, www.iasplus.com. We believe that it is the most comprehensive source of news about international financial reporting on the internet – please check in regularly.

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# Which version of IFRS 1?

In 2008, IFRS 1 was substantially rewritten (without altering the technical content) with the objective of making the Standard clearer and easier to follow by reorganising and moving the exceptions and exemptions into appendices. The improved structure is also intended to better accommodate ongoing changes to the Standard.

The revised Standard is effective for periods beginning on or after 1 July 2009, with earlier application permitted. For simplicity, the structure of this guide is based on the revised Standard, and references made are to the reorganised text.

Between November 2008 and the date of writing (October 2009), IFRS 1 has been amended twice:

- in January 2009, an additional exemption was introduced as a consequential amendment of IFRIC 18 *Transfers of Assets from Customers*; and
- in July 2009, additional exemptions were introduced relating to oil and gas assets, and arrangements involving leases.

These additional exemptions are discussed later in this guide; readers should pay particular attention to their effective dates.

In addition, readers should note that the May 2008 amendments to IFRS 1 and IAS 27 *Consolidated and Separate Financial Statements* dealing with the measurement of the cost of investments in subsidiaries, jointly controlled entities and associates (see **section 4.8**) are effective for annual periods beginning on or after 1 July 2009. Earlier application of these amendments is permitted – but, where they are applied for a period beginning before 1 July 2009, that fact is required to be disclosed.

In writing this guide, we have assumed that readers are concerned with accounting periods beginning on or after 1 January 2009. As explained above, we have based the structure of the guide on IFRS 1 as revised in November 2008 and further amended in July 2009. In addition, we have assumed that, where applicable, entities have adopted IFRS 8 *Operating Segments*, IAS 1(2007) *Presentation of Financial Statements*, IAS 23(2007) *Borrowing Costs* and other amendments to Standards effective from 1 January 2009. Users dealing with periods beginning before 1 January 2009 may need to consider previous versions of these Standards.

Finally, readers will note that the application of IFRS 1 varies according to whether the entity has adopted the 2008 revisions to IFRS 3 *Business Combinations* and IAS 27 *Consolidated and Financial Statements* (generally effective from 1 July 2009, but early adoption permitted subject to transitional provisions). Throughout this text, we have highlighted the areas affected by the differences between IFRS 3(2008) and IAS 27(2008) and their predecessor Standards.

# Abbreviations used in this guide

| | |
|---|---|
| CU | Currency Units (fictitious currency) |
| FASB | Financial Accounting Standards Board (US) |
| GAAP | Generally Accepted Accounting Principles |
| IAS(s) | International Accounting Standard(s) |
| IASB | International Accounting Standards Board |
| IFRIC | International Financial Reporting Interpretations Committee of the IASB, and title of Interpretations issued by that committee |
| IFRSs | International Financial Reporting Standard(s) |
| NCI | Non-controlling interest(s) |
| SFAS | Statement of Financial Accounting Standards (US) |

Throughout this guide, paragraphs that represent the authors' interpretations and examples other than those cited in IFRSs are highlighted by green shading.

# Definitions – quick reference

| | |
|---|---|
| Date of transition to IFRSs | The beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements. |
| Deemed cost | An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost. |
| Fair value | The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. |
| First IFRS financial statements | The first annual financial statements in which an entity adopts IFRSs by an explicit and unreserved statement of compliance with IFRSs. |
| First IFRS reporting period | The latest reporting period covered by an entity's first IFRS financial statements. |
| First-time adopter | An entity that presents its first IFRS financial statements. |
| IFRSs | Standards and Interpretations adopted by the IASB, comprising:<br>• International Financial Reporting Standards;<br>• International Accounting Standards; and<br>• Interpretations developed by the IFRIC or the former Standing Interpretations Committee (SIC). |
| Opening IFRS statement of financial position | An entity's statement of financial position at the date of transition to IFRSs. |
| Previous GAAP | The basis of accounting that a first-time adopter used immediately before adopting IFRSs. |

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# 1. Executive summary

The International Accounting Standards Board (IASB) published IFRS 1 *First-time Adoption of International Financial Reporting Standards* in 2003. Since then, significant amendments have been made to the Standard (primarily as a result of changes to other IFRSs). In November 2008, IFRS 1 was substantially rewritten (without altering the technical content) to make it a more user-friendly document. Most recently, the Standard was revised in July 2009 to introduce additional exemptions.

The purpose of IFRS 1 is to establish the rules for an entity's first financial statements prepared in accordance with IFRSs, particularly regarding the transition from the accounting principles previously applied by the entity (previous GAAP). Prior to the issuance of IFRS 1, first-time adopters were expected (in most cases) to retrospectively apply all IFRS requirements in their first IFRS-compliant financial statements. Recognising that this often resulted in costs that exceeded the benefits of the financial information generated, the IASB revised the approach to first-time adoption to include limited exemptions from the principle of retrospective application. As a result, IFRS 1 significantly eases the burden for first-time adopters.

The general principle underlying IFRS 1 is that IFRSs effective at the date of an entity's first IFRS financial statements should be applied retrospectively in the opening IFRS statement of financial position, the comparative period and the first IFRS reporting period. In practical terms, this means that if an entity adopts IFRSs for the year ended 31 December 2009, it must apply all IFRSs effective at that date retrospectively to the 2009 and 2008 reporting periods, and to the opening statement of financial position on 1 January 2008 (assuming only one year of comparative information is provided). Effectively, this general principle would result in full retrospective application of IFRSs as if they had been the framework for an entity's accounting since its inception. However, IFRS 1 adapts this general principle of retrospective application by adding a limited number of very important 'exceptions' and 'exemptions'. The 'exceptions' to retrospective application (of which there are four) are mandatory.
The 'exemptions' (16 in total) are optional – a first-time adopter may choose whether and which exemptions to apply. Careful analysis is required to fully understand the nature and impact of both the exceptions and the exemptions when applying IFRS 1.

An entity may only apply IFRS 1 in its first IFRS financial statements (a term tightly defined in IFRS 1 to mean the first annual financial statements in which the entity adopts IFRSs by an explicit and unreserved statement of compliance with IFRSs). The Standard provides specific examples of what might or might not qualify as an entity's first IFRS financial statements.

The Standard itself is lengthy, consisting of explanatory text as well as implementation guidance. While there is no substitute for a complete reading of the Standard, the following summary provides a reasonable starting point from which to build a more thorough understanding of the steps required in preparing an entity's first IFRS financial statements.

1. An opening IFRS statement of financial position is prepared at the date of transition. This is the starting point for an entity's accounting in accordance with IFRSs. The date of transition is the beginning of the first period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements. For entities that present one year of comparative information in their financial reports, the date of transition is the first day of the comparative period.

2. In its first IFRS financial statements, an entity applies the version of IFRSs effective at the end of its first IFRS reporting period. As a general principle, all IFRSs effective at that date are applied retrospectively, subject to certain exceptions and exemptions set out in IFRS 1. For example, an entity with a December year end that presents its first IFRS financial statements for its 2009 reporting period applies all IFRSs effective at 31 December 2009.

3. The entity recognises all assets and liabilities in accordance with the requirements of IFRSs, and derecognises assets and liabilities that do not qualify for recognition under IFRSs.

4. All adjustments resulting from the application of IFRSs to the opening IFRS statement of financial position are recognised in retained earnings (or, if appropriate, another category of equity) at the date of transition, except for reclassifications between goodwill and intangible assets.

5. With limited exceptions, estimates in accordance with IFRSs at the date of transition must be consistent with estimates made for the same date under previous GAAP.

6. An entity's first IFRS financial statements include at least three statements of financial position (including one at the date of transition, i.e. at the beginning of the comparative period), two statements of comprehensive income, two income statements (if presented), two statements of cash flows and two statements of changes in equity. All of these statements must be in compliance with IFRSs.

7. Entities are permitted to present historical summaries of certain data for periods before the date of transition which do not comply with IFRSs, as long as the information is prominently labelled as not being prepared in accordance with IFRSs. Where such information is presented, the entity must also explain the nature of the main adjustments that would be required to render the information compliant with IFRSs.

8. IFRS 1 requires compliance with all of the presentation and disclosure requirements of other Standards and Interpretations, and imposes additional disclosure requirements specific to the first IFRS financial statements. In particular, a first-time adopter is required to provide reconciliations between amounts reported under previous GAAP and the equivalent measures under IFRSs. These reconciliations must clearly identify the correction of any errors in relation to an entity's previous GAAP financial statements.

9. There are four mandatory exceptions to IFRS 1's general principle of retrospective application of IFRSs at the date of transition, and 16 optional exemptions. These exceptions and exemptions (listed below and discussed in detail in **sections 3 and 4**) are very specific, and may not be applied by analogy to other items.

*Exceptions to full retrospective application (mandatory)*

- Accounting estimates
- Derecognition of financial assets and financial liabilities
- Hedge accounting
- Non-controlling interests

*Exemptions from full retrospective application (optional)*

- Business combinations
- Share-based payment transactions
- Insurance contracts
- Deemed cost
- Leases
- Employee benefits
- Cumulative translation differences
- Investments in subsidiaries, jointly controlled entities and associates
- Assets and liabilities of subsidiaries, associates and joint ventures
- Compound financial instruments
- Designation of previously recognised financial instruments
- Fair value measurement of financial assets or financial liabilities at initial recognition
- Decommissioning liabilities included in the cost of property, plant and equipment
- Financial assets or intangible assets accounted for in accordance with IFRIC 12 *Service Concession Arrangements*
- Borrowing costs
- Transfers of assets from customers

# 2. An overview of IFRS 1

## 2.1 Objective of the Standard

The objective of IFRS 1 is to ensure that an entity's first IFRS financial statements (and interim financial reports for part of the period covered by those financial statements) contain high quality information that:

- is transparent for users and comparable over all periods presented;
- provides a suitable starting point for accounting under IFRSs; and
- can be generated at a cost that does not exceed the benefits to users.

## 2.2 Scope

Entities are required to apply IFRS 1 in their first IFRS financial statements and in each interim financial report, if any, prepared in accordance with IAS 34 *Interim Financial Reporting* for part of the period covered by those first IFRS financial statements.

An entity's first IFRS financial statements are the first annual financial statements in which it adopts IFRSs by including an explicit and unreserved statement of compliance with IFRSs.

A careful assessment of the specific facts and circumstances is required to determine whether financial statements fall within the scope of IFRS 1. The Standard notes by way of example that IFRS financial statements would be considered to be an entity's first IFRS financial statements if the entity presented its most recent previous financial statements:

- in accordance with national requirements that are not consistent with IFRSs in all respects;
- 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;
- containing an explicit statement of compliance with some, but not all, IFRSs;
- in accordance with national requirements inconsistent with IFRSs, using some individual IFRSs to account for items for which national requirements did not exist; or
- in accordance with national requirements, with a reconciliation of some amounts to the amounts determined under IFRSs.

The following statements made in an entity's most recent financial statements are not explicit and unreserved statements of compliance with IFRSs:

- a statement of compliance with previous GAAP that is inconsistent with or similar to IFRSs; or
- a statement of compliance with IFRSs except for certain Standards or disclosures.

If such a statement was made in the entity's most recent financial statements, the entity will nevertheless be considered a first-time adopter of IFRSs.

**Example – compliance with IFRSs in past years, but not the most recent previous year**

Company A issued financial statements in 20X1 and 20X2 with an unreserved statement of compliance with IFRSs. In its 20X3 financial statements, Company A stated compliance with local GAAP only. Company A is a first-time adopter in 20X4 because it did not make an explicit and unreserved statement of compliance with IFRSs in its most recent previous financial statements.

Further examples provided in IFRS 1 of situations where IFRS financial statements would be considered an entity's first IFRS financial statements include situations where an entity previously:

- prepared financial statements under IFRSs for internal use only, without making them available to the entity's owners or any other external users;
- prepared a reporting package under IFRSs for consolidation purposes without preparing a complete set of financial statements as defined in IAS 1 *Presentation of Financial Statements*; or
- did not present financial statements.

**Example – supplementary IFRS financial statements distributed to external users**

In 20X1, Company B prepared and presented its primary financial statements in accordance with local GAAP. It also prepared a supplementary set of financial statements stating compliance with IFRSs and distributed those supplementary financial statements to a select group of users (financial institutions). In 20X2, Company B intends to prepare its primary financial statements in accordance with IFRSs.

Company B will not be considered a first-time adopter in 20X2. If financial statements stating compliance with IFRSs have previously been issued externally, regardless of the extent of distribution, those financial statements prevent the entity from being regarded as a first-time adopter. The same principle would apply if an entity had previously issued a set of IFRS financial statements to the counterparties in a specific commercial transaction.

IFRS 1 is clear that it is inappropriate to apply the Standard when an entity:

- stops presenting financial statements in accordance with national requirements, having previously presented them as well as another set of financial statements that contained an explicit and unreserved statement of compliance with IFRSs;
- presented financial statements in the previous year in accordance with national requirements and those financial statements contained an explicit and unreserved statement of compliance with IFRSs; or
- presented financial statements in the previous year that contained an explicit and unreserved statement of compliance with IFRSs, even if the auditors qualified their audit report on those financial statements.

**Example – previous compliance with IFRSs, but with a qualified audit report**

In 20X1, Company C issued financial statements stating compliance with all IFRSs, and with an unqualified audit opinion. In 20X2, Company C's auditors note that certain disclosure requirements of IAS 1 were omitted, in error, from the 20X1 financial statements.

Company C is not within the scope of IFRS 1 for its 20X2 financial statements. While Company C should not have claimed unreserved compliance with IFRSs for its 20X1 financial statements, those financial statements have already been considered IFRS compliant and relied upon as such. Therefore, any errors are accounted for in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

## 2.3 Recognition and measurement – general principle

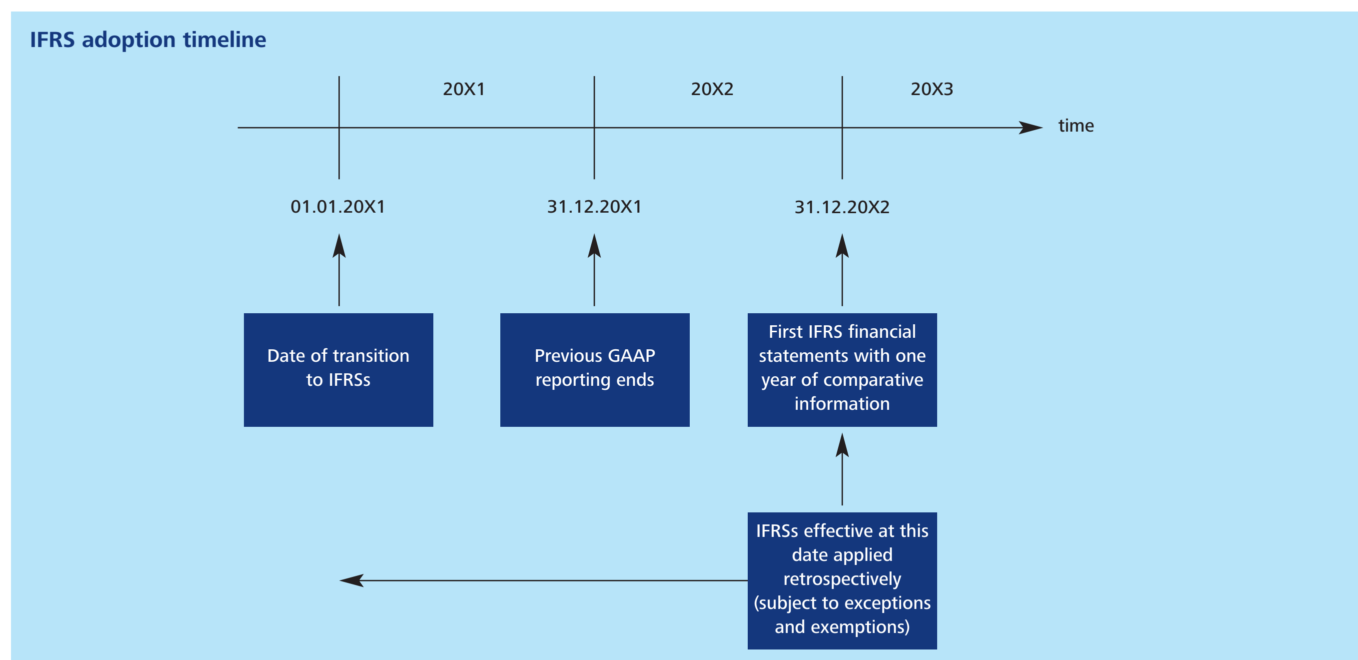
The general principle underlying IFRS 1 is that a first-time adopter should apply the version of each IFRS effective at the end of its first IFRS reporting period retrospectively. Therefore, the first IFRS financial statements are presented as if the entity had always applied IFRSs (subject to certain exemptions and exceptions, as discussed below).

The starting point in IFRS 1 is an opening IFRS statement of financial position prepared at the date of transition to IFRSs.

The date of transition to IFRSs is defined as "the beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements". The statement of financial position prepared at the date of transition (which is published in the first IFRS financial statements) is prepared in accordance with IFRS 1, including the general principle of retrospective application, the mandatory exceptions and the optional exemptions.

Entities are required to apply the same accounting policies in the opening IFRS statement of financial position and throughout all periods presented in the first IFRS financial statements. An entity may not therefore apply different versions of IFRSs that were effective at earlier dates. However, new IFRSs that are not yet mandatory may be applied if those IFRSs permit early adoption.

The following timeline summarises these requirements and illustrates key dates for a first-time adopter with a calendar year end that presents comparative information for one year.



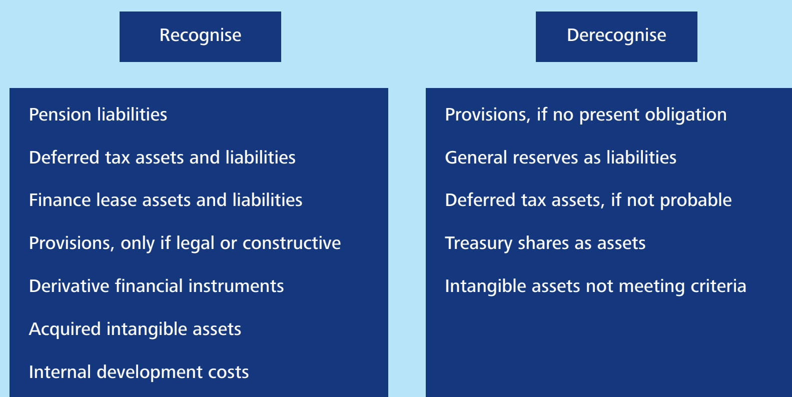

Because a first-time adopter is required to comply with all IFRSs effective at the reporting date, it is important to note that the specific transitional provisions of the individual Standards do not apply to a first-time adopter. Instead, a first-time adopter prepares the opening statement of financial position in accordance with the requirements of IFRS 1.

As illustrated in the timeline above, an entity's first IFRS financial statements are prepared to a date (31 December 20X2) at least two years after the date of transition to IFRSs (1 January 20X1). The opening statement of financial position is prepared 'as at' the date of transition to IFRSs, but using Standards effective at the first IFRS reporting date. It will, therefore, not be possible to finalise the opening IFRS statement of financial position until it is clear that no new or amended IFRSs will be effective for that period. If an entity publishes an opening IFRS statement of financial position before this is clear (in the example above, if the entity is required by local regulations to disclose information to the market regarding its IFRS position at the date of transition of 1 January 20X1, but the IASB is still considering amendments which may be effective for the December 20X2 financial statements), the entity should state that the amounts disclosed may need to be revised if there are subsequent pronouncements by the IASB that affect the period(s) presented.

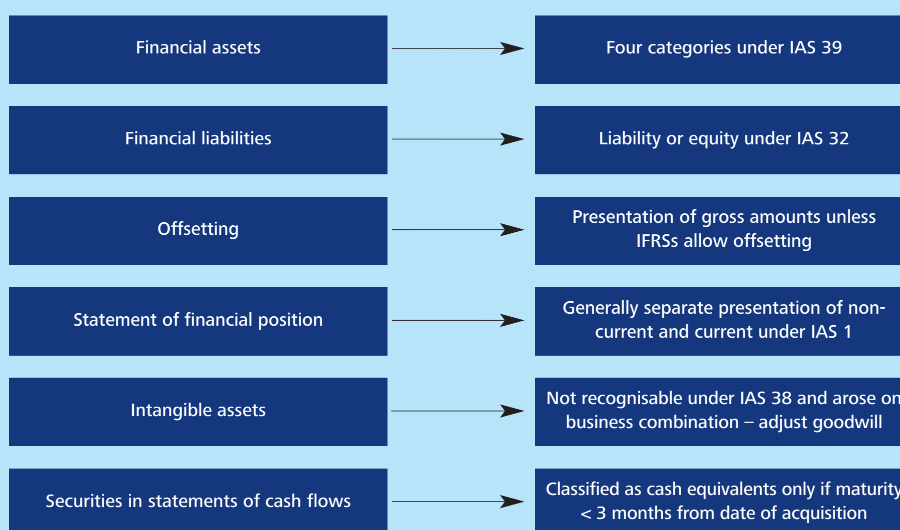
Subject to the exceptions and exemptions listed later in this section and discussed in detail in **sections 3 and 4** of this guide, a first-time adopter is required to:

- recognise all assets and liabilities whose recognition is required by IFRSs;
- not recognise items as assets and liabilities if IFRSs do not permit such recognition;
- reclassify items recognised under previous GAAP as one type of asset, liability or component of equity, but which are a different type of asset, liability or component of equity under IFRSs; and
- apply IFRSs in measuring all recognised assets and liabilities.

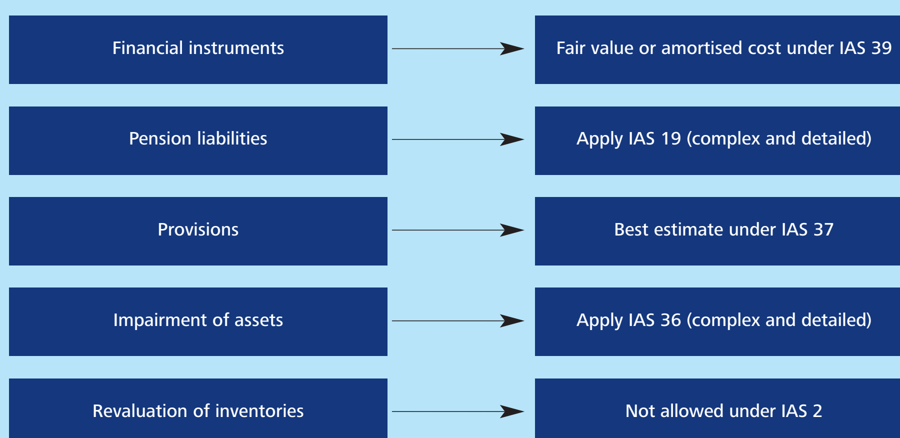
## Recognition and derecognition examples under IFRSs




## Reclassification examples under IFRSs




## Measurement examples under IFRSs



The transition to IFRSs could result in an entity having to change its accounting policies relating to recognition and/or measurement. The effect of this is generally recognised in equity in the opening IFRS statement of financial position, except in specific instances (e.g. intangible assets previously subsumed in goodwill).

The adjustments arising on transition will usually be recognised in retained earnings except in those cases where another Standard requires a separate component of equity to be recognised. For example, when an entity applies the revaluation model in IAS 16 *Property, Plant and Equipment*, the difference between fair value and depreciated cost at the date of transition will be credited to a revaluation reserve.

## 2.4 Exceptions to and exemptions from the general principle

### *2.4.1 Mandatory exceptions to retrospective application*

In the course of developing IFRS 1, the IASB identified four situations where they believed retrospective application of IFRSs could not be performed with sufficient reliability. The Board was primarily concerned about the potential for abuse if retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known. As a result, in those four situations (listed below), IFRS 1 prohibits full retrospective application of IFRSs. Each exception is discussed in more detail in **section 3** of this guide.

- Accounting estimates **(section 3.1**)
- Derecognition of financial assets and financial liabilities **(section 3.2)**
- Hedge accounting **(section 3.3)**
- Non-controlling interests **(section 3.4)**

### *2.4.2 Optional exemptions from the general principle*

Retrospective application of IFRSs can require significant resources and could, in some circumstances, be impracticable. The IASB decided that the costs of applying IFRSs retrospectively may exceed the benefits in certain instances. IFRS 1 therefore provides 16 optional exemptions from the general principle of full retrospective application, as listed below. A detailed discussion of each exemption can be found in **section 4** of this guide, with a focus on application issues that may arise.

- Business combinations **(section 4.1)**
- Share-based payment transactions **(section 4.2)**
- Insurance contracts **(section 4.3)**
- Deemed cost **(section 4.4)**
- Leases **(section 4.5)**
- Employee benefits **(section 4.6)**
- Cumulative translation differences **(section 4.7)**
- Investments in subsidiaries, jointly controlled entities and associates **(section 4.8)**
- Assets and liabilities of subsidiaries, associates and joint ventures **(section 4.9)**
- Compound financial instruments **(section 4.10.1)**
- Designation of previously recognised financial instruments **(section 4.10.2)**
- Fair value measurement of financial assets or financial liabilities at initial recognition **(section 4.10.3)**
- Decommissioning liabilities included in the cost of property, plant and equipment **(section 4.11)**
- Financial assets or intangible assets accounted for in accordance with IFRIC 12 *Service Concession Arrangements* **(section 4.12)**
- Borrowing costs **(section 4.13)**
- Transfers of assets from customers **(section 4.14)**

Because these exemptions are optional, entities may choose not to take advantage of them and to instead apply their IFRS accounting policies in these areas retrospectively, provided that the effects of retrospective application can be reliably calculated.

An entity that elects to apply one of these exemptions is not required to apply any (or all) of the other exemptions.

When more than one optional exemption affects an account balance, more than one exemption may be applied. Each optional exemption is applied independently. In determining which optional exemptions to apply, first-time adopters will therefore need to consider the advantages and disadvantages of each. There is no requirement to use a particular optional exemption as a result of choosing another exemption.

For example, an entity might not restate a business combination prior to the date of transition so that the deemed cost of property, plant and equipment is the carrying amount under previous GAAP immediately after the business combination. The entity can override this deemed cost with a later deemed cost, such as fair value at the date of transition.

Analogous application of the optional exemptions to other areas is not permitted.

For example, a first-time adopter cannot use fair value or the carrying amount of an item as deemed cost on the date of transition except as specifically set out in the exemption. The Standard specifies limited circumstances where retrospective restatement in accordance with IFRSs is not required. Unless the amount is immaterial, in any other circumstances IFRSs should be applied retrospectively.

## 2.5 Presentation and disclosure requirements

The presentation and disclosure requirements of IFRS 1 are listed in full in Appendix B to this guide.

### *2.5.1 Compliance with the presentation and disclosure requirements of other Standards*

An entity's first IFRS financial statements are required to comply with the presentation and disclosure requirements of IAS 1 *Presentation of Financial Statements* and the other Standards and Interpretations under IFRSs. IFRS 1 does not provide any relief from the presentation and disclosure requirements of the individual Standards (in fact, it imposes additional requirements – see below).

An entity's first IFRS financial statements are required to include three statements of financial position, two statements of comprehensive income, two income statements (if presented), two statements of cash flows, two statements of changes in equity, and related notes, including comparative information.

When an entity presents selective information for previous years, or states key figures or ratios for previous years, IFRS 1 does not require such information to be prepared in accordance with IFRSs. However, the entity is required to state clearly that the amounts are not calculated in accordance with IFRSs and to disclose the nature of the adjustments (not required to be quantified) that would be required to bring them into line with IFRSs.

The requirement to comply with all IFRS presentation and disclosure requirements in the first IFRS financial statements can be quite onerous. Some of the Standards which may have a significant impact on an entity's presentation and disclosure requirements include IFRS 2 *Share-based Payment*, IFRS 3 *Business Combinations*, IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, IFRS 7 *Financial Instruments: Disclosures*, IFRS 8 *Operating Segments*, IAS 19 *Employee Benefits*, IAS 33 *Earnings per Share*, IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. In practice, meeting these disclosure requirements is burdensome, and detailed and numerous changes to reporting and information gathering systems may be necessary.

### *2.5.2 Explaining the transition to IFRSs*

First-time adopters are required to clearly explain how the transition from previous GAAP to IFRSs affected their previously reported financial position, financial performance and cash flows. To comply with this requirement, IFRS 1 requires the presentation of the reconciliations listed below in an entity's first IFRS financial statements.

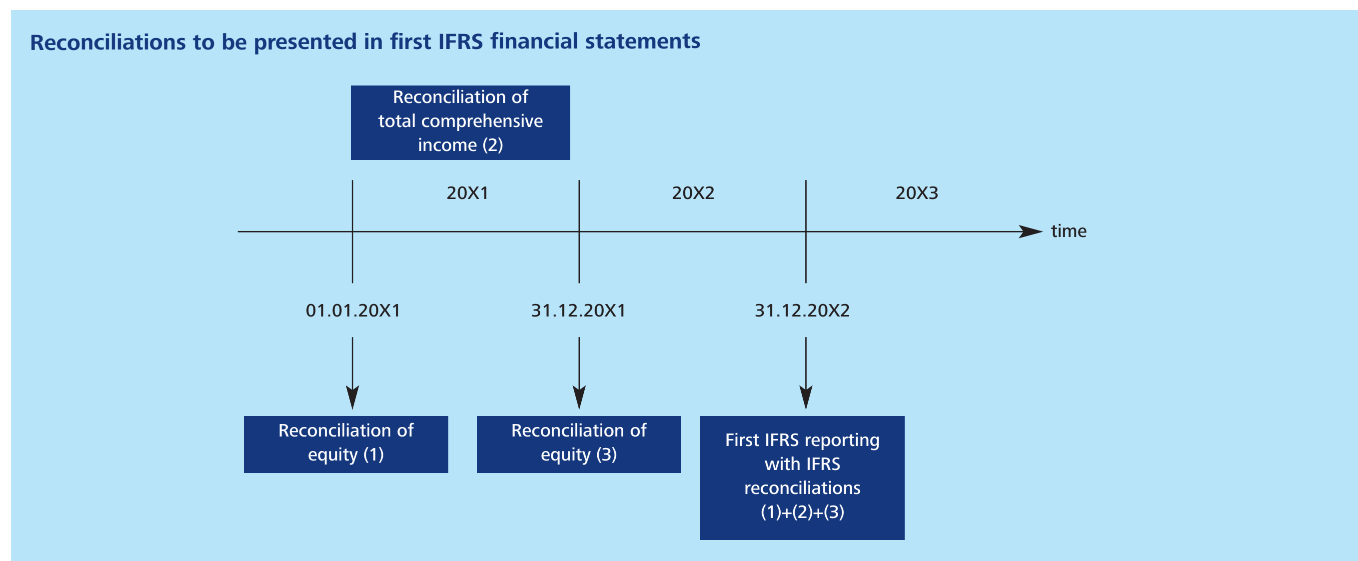
- Reconciliations of equity reported under previous GAAP to equity under IFRSs as at:

  – the date of transition to IFRSs; and

  – the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP.

- Reconciliation to total comprehensive income under IFRSs for the latest period in the entity's most recent annual financial statements. The starting point for that reconciliation is total comprehensive income under previous GAAP for the same period or, if the entity did not report such a total, profit or loss under previous GAAP.

The following diagram sets out the required reconciliations for an entity adopting IFRSs in the year ending 31 December 20X2, with a transition date of 1 January 20X1. These reconciliations are illustrated in Example 11 accompanying IFRS 1 and in Appendix A to this guide.




In addition, if an entity recognised or reversed any impairment losses for the first time in preparing its opening IFRS statement of financial position, the entity is required to provide the disclosures that IAS 36 *Impairment of Assets* would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to IFRSs.

Supplementary explanations necessary for understanding the transition to IFRSs are also required in the first IFRS financial statements. Explanations provided should be sufficient to enable users to properly understand the material adjustments to the statement of financial position, the statement of comprehensive income and the statement of cash flows (when a statement of cash flows was previously presented). In addition, the reconciliations should clearly distinguish between errors made under previous GAAP (if any) and adjustments arising due to changes in accounting policies.

### *2.5.3 Interim reporting*

IFRSs do not require an entity to publish interim financial reports in compliance with IAS 34 *Interim Financial Reporting*. Neither does IFRS 1 require a first-time adopter to publish interim financial reports in advance of an entity's first IFRS financial statements.

When an interim financial report is presented in accordance with IAS 34 for part of the period covered by an entity's first IFRS financial statements, IFRS 1 requires additional disclosures in that interim report, including reconciliations between previous GAAP and IFRSs. Comparative information is required to be restated in accordance with IAS 34.

For example, an entity's date of transition is 1 January 20X4 and it presents a quarterly report at 31 March 20X5 in accordance with IAS 34. The entity presented an interim report under previous GAAP for the same period in the immediately preceding financial year. The following reconciliations are required under IFRS 1 in addition to the requirements in IAS 34.

Reconciliation of equity reported under previous GAAP to equity under IFRSs at:

- the date of transition to IFRSs (1 January 20X4);
- the end of the corresponding period in the prior year (31 March 20X4); and
- the end of the latest annual financial year presented under previous GAAP (31 December 20X4).

Reconciliation of total comprehensive income under previous GAAP (or, if total comprehensive income was not reported under previous GAAP, of profit or loss under previous GAAP) to total comprehensive income under IFRSs for:

- the comparable interim period (current and year-to-date) (1 January 20X4 to 31 March 20X4); and
- the latest annual financial year presented under previous GAAP (1 January 20X4 to 31 December 20X4).

### *2.5.4 Comparative information*

An entity's first IFRS financial statements are required to include at least one year of comparative information under IFRSs. As previously noted, the date of transition to IFRSs is defined as the beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements.

Some reporting frameworks, stock exchange regulators or other governing bodies may require an entity to present more than one year of comparative information in accordance with IFRSs. If an entity elects or is required to present more than one year of full comparative information prepared in accordance with IFRSs, the date of transition is the beginning of the earliest period presented. All comparative information subsequent to the date of transition is restated and presented in accordance with IFRSs.

For example, an entity is listed on an overseas stock exchange and that exchange requires the presentation of two years of full comparative information. The entity's first IFRS financial statements are prepared for the year ended 31 December 20X9.

The entity's date of transition is 1 January 20X7 because that is the beginning of the earliest period presented in its first IFRS financial statements. Consequently, all three periods presented (20X7, 20X8 and 20X9) should be prepared in accordance with IFRSs based on an opening IFRS statement of financial position prepared at 1 January 20X7.

### *2.5.5 Other disclosure requirements*

A first-time adopter is required to disclose the fair value of financial assets or financial liabilities designated at the date of transition either as 'at fair value through profit or loss' or as 'available-for-sale', and the classification and carrying amount of those financial assets and financial liabilities in its previous financial statements.

If the election to use fair value as deemed cost is applied to property, plant and equipment, investment property or intangible asset, the following disclosures are required in the entity's first IFRS financial statements for each line item in the opening IFRS statement of financial position:

- the aggregate of those fair values; and
- the aggregate adjustment to the carrying amounts reported under previous GAAP.

Also, if the first-time adopter uses a deemed cost in its opening IFRS statement of financial position in its separate financial statements for an investment in a subsidiary, associate or jointly controlled entity, those separate financial statements are required to disclose:

- the aggregate deemed cost of those investments for which deemed cost is their previous GAAP carrying amount;
- the aggregate deemed cost of those investments for which deemed cost is fair value; and
- the aggregate adjustment to the carrying amounts reported under previous GAAP.

# 3. Mandatory exceptions

The general principle of IFRS 1 is that all IFRSs should be applied retrospectively in an entity's first IFRS financial statements and/or each interim financial report for part of the period covered by its first IFRS financial statements (if the report is prepared in accordance with IAS 34). However, the IASB has determined that retrospective application in certain situations cannot be performed with sufficient reliability. In those situations, which are listed below, full retrospective application is prohibited.

## 3.1 Accounting estimates

Accounting estimates required under IFRSs that were made under previous GAAP may not be adjusted on transition except to reflect differences in accounting policies or unless there is objective evidence that the estimates were in error. The primary objective of this exception is to prevent entities using the benefit of hindsight to adjust estimates based on circumstances and information which were not available when the amounts were originally estimated under previous GAAP.

When restating previous GAAP amounts for the purpose of its opening IFRS statement of financial position, an entity may have information available that was not available at the time the estimate was made. This information is treated as 'non-adjusting' (i.e. the amounts recognised are not adjusted). IFRS 1 gives the following example to illustrate this requirement.

An entity's date of transition to IFRSs is 1 January 20X4. New information on 15 July 20X4 requires the revision of an estimate made under previous GAAP at 31 December 20X3. The entity does not reflect the new information in its opening IFRS statement of financial position unless the estimate needs adjustment for any differences in accounting policies or there is objective evidence that the estimate was in error at 31 December 20X3. Instead, the entity reflects the new information in profit or loss (or, if appropriate, other comprehensive income) for the year ended 31 December 20X4.

This principle also applies to comparative information presented in an entity's first IFRS financial statements. Therefore, estimates made at the end of the comparative period (in the example above, 31 December 20X4) should follow the same rules as the opening IFRS statement of financial position as regards the use of hindsight.

When an estimate is required under IFRSs at the date of transition that was not required under previous GAAP, the estimate should reflect conditions at the date of transition. In particular, estimates of market prices, interest rates and foreign exchange rates should reflect market conditions at the date of transition.

A first-time adopter needs to be aware of the inputs that will be required to construct estimates at the date of transition and at the end of the comparative period for the purposes of its first IFRS financial statements. The entity will need to ensure that the required information is obtained at the date of transition (and at the end of the comparative period), even if the estimates/calculations are not completed until a later time.

The implementation guidance accompanying IFRS 1 explains that this exception does not override requirements in other IFRSs to base classifications or measurements on circumstances existing at a particular date. This means that if an estimate is required at a specific date, the entity is required to adjust those estimates to be in accordance with IFRSs. Examples given in the implementation guidance are:

- classification of finance leases and operating leases under IAS 17 *Leases*;
- restrictions in IAS 38 *Intangible Assets* that prohibit capitalisation of an internally generated intangible asset if that asset did not qualify for recognition when the expenditure was incurred; and
- classification of financial instruments as equity instruments or financial liabilities in IAS 32 *Financial Instruments: Presentation*.

## 3.2 Derecognition of financial assets and financial liabilities

A first-time adopter is required to apply the derecognition rules in IAS 39 *Financial Instruments Recognition and Measurement* prospectively from 1 January 2004 unless it chooses to apply the derecognition rules of IAS 39 retrospectively from a date of its choosing (see below). Therefore, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities under its previous GAAP in a securitisation, transfer or similar derecognition transaction that occurred before 1 January 2004, it does not recognise those financial assets and liabilities at the date of transition (even if they would not have qualified for derecognition under IAS 39) unless they qualify for recognition as a result of a later transaction or event.

Notwithstanding the requirement to apply IAS 39's rules on derecognition prospectively from 1 January 2004, an entity may opt to apply them retrospectively from a date of its own choosing, provided that the information needed to apply IAS 39 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of the initial accounting for those transactions.

## 3.3 Hedge accounting

A first-time adopter is required in its opening IFRS statement of financial position to:

- measure all derivatives at fair value; and
- eliminate all deferred gains and losses arising on derivatives that were reported under previous GAAP as assets and liabilities.

Under IAS 39, a hedging relationship only qualifies for hedge accounting if a number of restrictive criteria are satisfied, including appropriate designation and documentation of effectiveness at inception of the hedge and subsequently. A hedging relationship will only qualify for hedge accounting at the date of transition if the hedging relationship has been fully designated and documented as effective in accordance with IAS 39 on or before the date of transition and is of a type that qualifies for hedge accounting under IAS 39. Designation of a hedging relationship cannot be made retrospectively.

For a first-time adopter, this may be a significant change from previous GAAP which may not have required such rigorous hedge designation and documentation. Hedge accounting under IAS 39, and therefore on first-time adoption, can be applied prospectively only from the date that the hedge relationship is fully designated and documented subject to all other hedge accounting requirements of IAS 39 being met.

However, if an entity designated a net position as a hedged item under previous GAAP, it may designate an individual item within that net position as a hedged item, provided that the designation is made by the date of transition.

Hedging relationships that were designated as hedges under previous GAAP, but which do not qualify for hedge accounting under IAS 39, are treated in accordance with the requirements of IAS 39 relating to the discontinuation of hedge accounting.

Under previous GAAP, gains and losses on a cash flow hedge of a forecast transaction may have been deferred in equity. If, at the date of transition, the transaction is still highly probable and the hedging relationship was designated appropriately and documented as effective, hedge accounting may be continued in accordance with IAS 39. If the forecast transaction is not highly probable, but is still expected to occur, the entire deferred gain or loss remains in equity until the forecast transaction occurs.

## 3.4 Non-controlling interests

This exception applies for entities that have adopted the 2008 amendments to IFRS 3 *Business Combinations* and IAS 27 *Consolidated and Separate Financial Statements*. These amendments introduced new measurement requirements for non-controlling interests (previously described as 'minority' interests) and a new mandatory exception to IFRS 1.

The exception stipulates that a first-time adopter should apply the following requirements of IAS 27(2008) prospectively from the date of transition to IFRSs:

- the requirement that total comprehensive income be attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance;
- the requirements regarding the accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and
- the requirements regarding the accounting for a loss of control over a subsidiary, and the related requirements in paragraph 8A of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

This exception is effective for annual periods beginning on or after 1 July 2009. However, if a first-time adopter elects to apply IFRS 3(2008) and IAS 27(2008) for an earlier period, the amendments to IFRS 1 should also be applied for that earlier period.

# 4. Optional exemptions

This section covers all of the optional exemptions from the general principle of full retrospective application allowed under IFRS 1. Each exemption is discussed in detail, including consideration of practical implementation issues.

## 4.1 Business combinations

Relevant IFRSs: IFRS 3 *Business Combinations*

IFRS 3 was revised in January 2008. The new Standard, referred to as IFRS 3(2008), is applicable to business combinations for which the acquisition date occurs during the first annual reporting period beginning on or after 1 July 2009. Earlier application is permitted, subject to transitional provisions – but not for accounting periods beginning before 30 June 2007. For entities that already apply IFRSs, the requirements of IFRS 3(2008) apply prospectively (with certain exceptions); therefore, such entities do not need to amend the accounting for earlier business combinations.

For first-time adopters:

- if the first IFRS reporting period begins before 30 June 2007, IFRS 3(2008) may not be applied;
- if the first IFRS reporting period begins between 1 July 2007 and 30 June 2009, IFRS 3(2008) may be applied in advance of its effective date, subject to the general transitional provisions; and
- if the first IFRS reporting period begins on or after 1 July 2009, IFRS 3(2008) must be applied.

For the majority of this section of our guide, we have assumed that IFRS 3(2008) is being applied. The implications of first-time adoption for entities applying the previous version of the Standard (IFRS 3(2004)) are discussed in a later part of this section.

It is important to note that if retrospective application of IFRS 3(2008) is selected, IFRS 1 requires consistent application of IFRS 3(2008) – i.e. IFRS 3(2004) should not be applied to any of the entity's previous business combinations.

One of the most complex areas that first-time adopters will need to address is the accounting for business combinations. Entities will need to consider whether to apply IFRS 3 *Business Combinations* retrospectively to all past business combinations, or to avail of the IFRS 1 exemption in this regard. Even where the exemption is applied, significant issues can arise. In this section, we have set out the implications of the choices available and a comparison of the resultant accounting.

Entities are permitted to apply IFRS 3 retrospectively to all past business combinations (theoretically, back to incorporation of the entity). Full retrospective application could be very onerous and, in many cases, will be impracticable. Any entity intending to follow this path will need to ensure that it has the information needed to apply the acquisition method retrospectively in accordance with IFRS 3, which in particular includes:

- calculation of the cost of the business combination;
- identification of assets acquired (including any intangible assets), and liabilities and contingent liabilities assumed;
- measurement of fair value at the date of acquisition of assets acquired and liabilities and contingent liabilities assumed; and
- impairment test of goodwill each year subsequent to the date of acquisition.

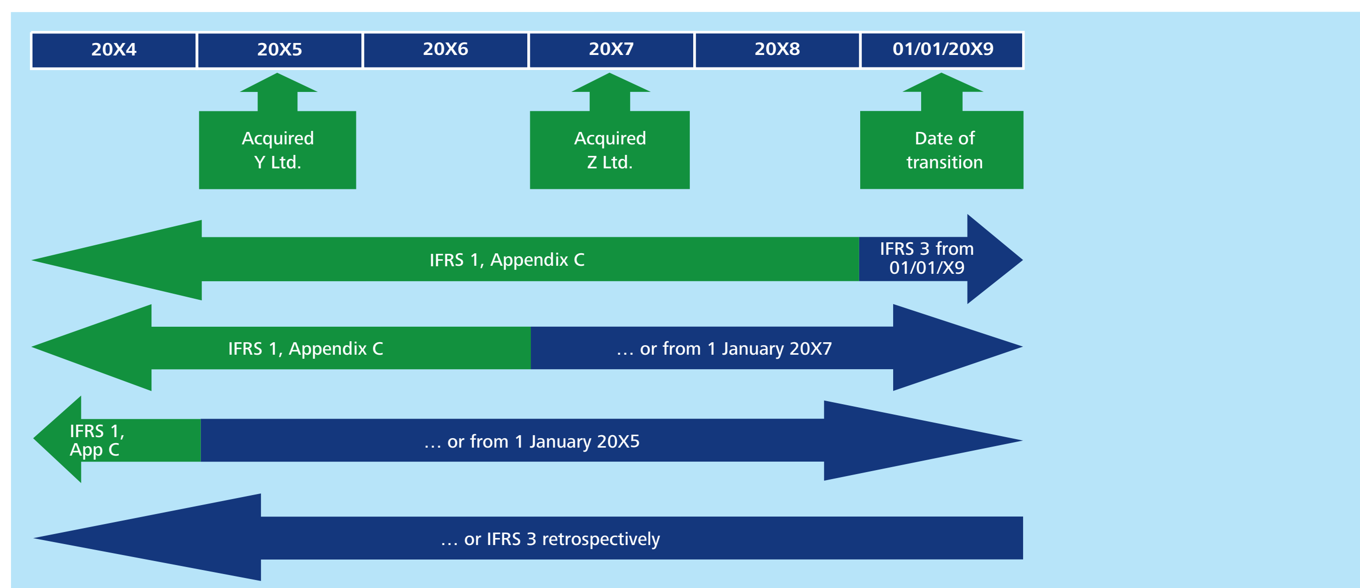
As an alternative to applying IFRS 3 retrospectively, IFRS 1 includes an optional exemption for business combinations, set out in Appendix C of the Standard. The most significant features of the accounting under IFRS 1, Appendix C are that:

- the classification of former business combinations (acquisition or uniting of interests) under previous GAAP is maintained;
- there is no re-measurement of original 'fair values' determined at the time of the business combination (date of acquisition); and
- the carrying amount of goodwill recognised under previous GAAP is not adjusted, other than in specific instances.

### 4.1.1 Timing the use of the exemption

An entity may utilise the exemption to avoid applying IFRS 3 retrospectively to any business combination that occurred before the date of transition to IFRSs. In such circumstances, IFRS 3 is applied prospectively for business combinations from the date of transition. However, the entity may elect to restate business combinations from any date prior to the date of transition. If any business combination is restated, then all later business combinations must also be restated.

If business combinations prior to the date of transition are restated, they must be restated to conform with the requirements of whichever version of IFRS 3 is effective at the date of the first-time adopter's first IFRS reporting period. Therefore, if an entity with a first IFRS reporting period ending on 31 December 2010 elects to apply IFRS 3 for business combinations occurring after 1 January 2005, IFRS 3(2008) is applied to all restated combinations, notwithstanding that the general transitional provisions of IFRS 3(2008) do not permit that Standard to be applied before 30 June 2007. Furthermore, if IFRS 3(2008) is being applied, IAS 27 (as amended in 2008) and the consequential amendments to other Standards must also be applied from the same date. It also has to apply the revised version of IAS 27 from 1 September 2007. These requirements are illustrated in the following diagram.




The exemption for past business combinations also applies to past acquisitions of associates and of interests in joint ventures. The selected date applies equally for acquisitions of investments in associates and interests in joint ventures. In such circumstances, a first-time adopter also applies IAS 28 and IAS 31 retrospectively to acquisitions of investments in associates and interests in joint ventures from the same date that IFRS 3 is applied retrospectively. Therefore, if an entity decides to restate an acquisition of a subsidiary at a date prior to the date of transition, all acquisitions of subsidiaries, associates and joint ventures after that date must also be restated. Equally, if an entity chooses to restate an acquisition of an associate at a date prior to the date of transition to IFRSs, all acquisitions of subsidiaries, other associates and joint ventures after that date must also be restated.

Although IFRS 1 provides an exemption from the requirement to restate business combinations that occurred before the date of transition to IFRSs, it is very important to appreciate that this does not simply mean that all amounts recognised under previous GAAP relating to such business combinations can be carried forward under IFRSs. The detailed rules are quite complex and are discussed in the remainder of this section.

### *4.1.2 Classification of previous business combinations*

Under previous GAAP, a business combination may have been classified differently than IFRSs would require for the same business combination. For example, under previous GAAP an acquisition may have been classified as:

- a uniting of interests (also known as a 'pooling of interests'), which is not permitted under IFRS 3; or
- an acquisition following the legal form, which would have been classified as a reverse acquisition under IFRS 3.

If an entity elects to apply the optional exemption for business combinations, the classification under previous GAAP is retained. If the entity instead elects to apply IFRS 3 retrospectively, the classification is changed retrospectively to comply with IFRS 3.

The determination as to whether a transaction qualifies for the business combination exemption depends on whether that combination meets the definition of a business combination under IFRSs. If the transaction meets the definition, regardless of whether it met the definition under the entity's previous GAAP, use of the exemption for business combinations is permitted for that transaction.

### *4.1.3 Recognition of assets and liabilities*

All assets acquired and liabilities assumed in a business combination that qualify for recognition under IFRSs are recognised at the date of transition, except for some financial assets and liabilities derecognised under previous GAAP (see section 3.2).

Assets and liabilities are recognised in accordance with the relevant IFRS for the specific item. Therefore, under the optional exemption, research projects and contingent liabilities existing at the date of acquisition are not separated from goodwill, as they would be if IFRS 3 were applied for the same business combination.

Any adjustments arising as a result of the recognition of assets and liabilities not recognised under previous GAAP are recognised in retained earnings (or another relevant category of equity), other than those related to intangible assets acquired in a business combination and not previously recognised. Adjustments to those assets are adjusted against goodwill (see section 4.1.5).

Assets acquired and liabilities assumed that do not qualify for recognition under IFRSs, but that were recognised under previous GAAP, are derecognised. The resulting adjustments are recognised in retained earnings, unless they relate to an intangible asset (in which case they are adjusted against goodwill).

### *4.1.4 Measurement of assets and liabilities*

The measurement of assets acquired and liabilities assumed in a business combination may be different to that of other assets and liabilities of the entity. The optional exemption for business combinations provides the following three measurement bases for assets and liabilities.

| | Assets and liabilities that are: | | |
|---|---|---|---|
| **Measurement basis** | **Measured on a basis other than cost under IFRSs** | **Measured on a cost basis** | **Not previously recognised** |
| IFRS 1 requirement | In accordance with applicable IFRS measurement basis (e.g. fair value) at date of transition | Carrying amount immediately after the business combination under previous GAAP (deemed cost) less accumulated depreciation under IFRSs | Basis that IFRSs would require in separate financial statements of acquiree |
| Examples | • Financial assets designated as at fair value through profit or loss<br>• Property, plant and equipment measured under the revaluation model<br>• Defined benefit liabilities recognised<br>• Provisions | • Property, plant and equipment measured under the cost model<br>• Financial assets and liabilities measured at amortised cost<br>• Inventories | • Finance leases **not** previously recognised<br>• Intangible assets **not** previously recognised.<br>• Defined benefit liabilities **not** previously recognised |

If an asset acquired or a liability assumed in a business combination was not recognised under previous GAAP, it does not have a deemed cost of nil in the opening IFRS statement of financial position. Instead, the acquirer recognises and measures the asset or liability in its consolidated statement of financial position on the basis that IFRSs would require in the separate statement of financial position of the acquiree as if the acquiree had always applied IFRSs. The resulting adjustments are recognised in retained earnings.

**Example – finance lease not capitalised under previous GAAP**

Parent Company A's date of transition is 1 January 20X5. Parent Company A acquired Subsidiary B on 15 January 20X3 and did not capitalise Subsidiary B's finance leases entered into prior to 15 January 20X3. If Subsidiary B prepared separate financial statements under IFRSs, it would recognise finance lease obligations of CU750 and leased assets of CU625 at 1 January 20X5.

Upon transition to IFRSs, in its consolidated opening IFRS statement of financial position, Parent Company A should recognise Subsidiary B's finance lease obligations at CU750 and leased assets at CU625, and the net resulting change of CU125 is recognised in retained earnings at that date.

### *4.1.5 Goodwill*

As a general principle, under the optional exemption, the carrying amount of goodwill in the opening IFRS statement of financial position is its carrying amount under previous GAAP – adjusted only for the following items.

| Item | Adjustment to goodwill |
| --- | --- |
| Intangible assets recognised under previous GAAP but not under IFRSs | Carrying amount of the intangible asset at date of transition (less deferred tax and non-controlling interests) is added to goodwill |
| Intangible assets not recognised under previous GAAP but qualify for recognition under IFRSs (e.g. IAS 38) | The amount at which the intangible asset would have been recognised in the separate IFRS financial statements of the acquiree at the date of transition (less deferred tax and non-controlling interests) is deducted from goodwill |
| Impairment of goodwill | Any impairment loss resulting from testing goodwill at the date of transition is deducted from goodwill |

No other adjustments to goodwill are permitted at the date of transition when applying the optional exemption. IFRS 1 highlights the following examples for which goodwill is not adjusted:

- to exclude in-process research and development acquired in a business combination (unless it qualifies for separate recognition by the acquiree under IAS 38);
- to adjust previous amortisation of goodwill; and
- to reverse adjustments to goodwill that IFRS 3 would not permit, but that were made under previous GAAP as a result of adjustments to assets and liabilities between the date of acquisition and the date of transition.

Although there is no explicit prohibition in IFRS 1 on the reversal of a past impairment of goodwill, this is similar to the reversal of past amortisation which is prohibited. Also, the list of permitted adjustments to goodwill refers only to 'any resulting impairment loss' and does not envisage a profit arising from the impairment review of goodwill at the date of transition.

From the date of transition, goodwill is no longer amortised. As a result, IFRS 1 requires that goodwill be tested for impairment at the date of transition, in accordance with IAS 36 *Impairment of Assets*, irrespective of whether there is any indication that goodwill may be impaired. The effect of any impairment loss identified is deducted from equity in the opening IFRS statement of financial position.

When goodwill has been amortised under previous GAAP, the carrying amount of accumulated amortisation at the date of transition is adjusted against the original cost of goodwill. The net amount is carried forward as the new carrying amount under IFRSs.

If the entity selects its date of transition (e.g. 1 January 20X4) as the date from which it applies IFRS 3, goodwill amortisation recognised under previous GAAP in the 20X4 consolidated financial statements is reversed in retained earnings at 1 January 20X4 in the first IFRS financial statements for 20X5. Comparative information for 20X4 is restated correspondingly. Furthermore, goodwill is tested for impairment at 1 January 20X4 under IAS 36. Any resulting impairment losses are recognised in retained earnings at 1 January 20X4. Business combinations for which the date of acquisition is during 20X4 or 20X5 are accounted for under IFRS 3.

However, if the entity elects to apply IFRS 3 for all business combinations after an earlier date, e.g. 1 January 20X2, in addition to reversing goodwill amortisation for 20X4 for all business combinations, the entity is also required to reverse the goodwill amortisation recognised under previous GAAP in 20X2 and 20X3 related to those business combinations for which the date of acquisition is after 1 January 20X2. This requires that the entity already have the information needed to apply the acquisition method retrospectively in accordance with IFRS 3, and that goodwill is tested annually for impairment as from 1 January 20X2 and that any impairment loss in the period from 1 January 20X2 to 31 December 20X3 is recognised in retained earnings at 1 January 20X4. In this example, for business combinations with a date of acquisition before 1 January 20X2, goodwill will continue to be amortised until the date of transition.

**Example – costs of development projects not recognised under previous GAAP**

Parent Company C acquired Subsidiary D on 1 January 20X2. Parent Company C adopts IFRSs in 20X6 with date of transition 1 January 20X5. Under previous GAAP, development costs were expensed as incurred. Had Subsidiary D applied IFRSs, development costs of CU20 related to a project completed at 31 December 20X1 would have been recognised as an internally generated intangible asset. The useful life of the project is 5 years. The fair value is assessed to be CU18 at 1 January 20X2 and CU10 at the date of transition 1 January 20X5. Parent Company C is using the optional exemption for business combinations under IFRS 1, Appendix C. The following journal entry is required at the date of transition.

| | CU | CU |
|---|---|---|
| Dr. Development costs | 20 | |
| Cr. Accumulated amortisation [CU20 x 3/5] | | 12 |
| Cr. Goodwill [CU20 – CU12] | | 8 |

The development costs were not recognised under previous GAAP. The acquirer, Parent Company C, recognises and measures the development costs in its consolidated opening IFRS statement of financial position on the basis that IFRSs would require in the separate statement of financial position of Subsidiary B. At the date of transition, this amount is CU8 (CU20 amortised over 3 out of 5 years). Goodwill is adjusted accordingly because the asset was previously subsumed within goodwill.

The option in IFRS 1 to measure intangible assets at fair value is not available in this case, as no active market exists.

**Example – amortisation of software not in compliance with IFRSs**

Parent Company E acquired Subsidiary F on 1 January 20X3. Parent Company E adopts IFRSs in 20X6 with date of transition 1 January 20X5. On 31 December 20X1, Subsidiary B acquired software for CU30. The useful life of the software is 6 years; however under previous GAAP, amortisation of software was restricted to the straight-line method over a maximum of 3 years. At 31 December 20X4, the asset was completely amortised under previous GAAP and was therefore removed from records. The fair value as at 1 January 20X3 is assessed to be CU25 which is equal to the carrying amount at the same date had Subsidiary F always applied IFRSs. The useful life is unchanged at the date of acquisition which means that the remaining useful life at that date is 5 years. Parent Company E is using the optional exemption for business combinations under IFRS 1.

| | **Carrying amount under previous GAAP CU** | **Carrying amount in separate financial statements had Subsidiary B always applied IFRSs CU** |
|---|---|---|
| 31 December 20X1 | 30 | 30 |
| 31 December 20X2 | 20 | 25 |
| **1 January 20X3 (date of acquisition)** | **20** | **25** |
| 31 December 20X3 | 10 | 20 |
| 31 December 20X4 | 0 | 15 |
| **1 January 20X5 (date of transition)** | **0** | **15** |
| 31 December 20X5 | 0 | 10 |
| 31 December 20X6 | 0 | 5 |
| 31 December 20X7 | 0 | 0 |

The following journal entry is required at the date of transition.

| | CU | CU |
|---|---|---|
| Dr. Software costs | 20 | |
| Cr. Accumulative amortisation [CU20 x 2/5] | | 8 |
| Cr. Retained earnings [CU20 – CU8] | | 12 |

The carrying amount under previous GAAP of the software immediately after the business combination is deemed cost (CU20). As software requires a cost-based measurement, deemed cost is the basis for amortisation under IFRSs from the date of acquisition. The remaining useful life as at 1 January 20X3 is 5 years and, consequently, the carrying amount in the opening IFRS statement of financial position is CU12 (CU20 amortised over 2 out of 5 years). Goodwill is not adjusted because software was recognised separately under previous GAAP (but, in this specific example, it had been fully amortised before the date of transition, 1 January 20X5).

#### 4.1.5.1 Goodwill deducted from equity

If goodwill was deducted from equity under previous GAAP, a first-time adopter does not recognise that goodwill as an asset in the opening IFRS statement of financial position.

On disposal of the subsidiary or business that gave rise to the goodwill previously deducted from equity, the amount previously deducted from equity is not transferred to profit or loss as part of the net gain or loss on disposal.

#### 4.1.5.2 'Negative goodwill'

Under the optional exemption for business combinations, any 'negative goodwill' recognised under previous GAAP is derecognised, with a corresponding adjustment to retained earnings at the date of transition.

### *4.1.6 Non-controlling interests and deferred tax*

The exemption for business combinations requires that the measurement of non-controlling interests (NCI) and deferred tax follows from the measurement of other assets and liabilities. Therefore, even if an entity decides to avail of the business combination exemption and not restate prior business combinations, some adjustment to non-controlling interests and deferred tax may still be required.

**Example – change in treatment of non-controlling interest on first-time adoption**

Entity G adopts IFRSs in 20X9 with a date of transition of 1 January 20X8. Entity G acquired an 80% interest in Entity H on 30 June 20X6 and has decided not to restate the business combination on adoption of IFRSs.

Under previous GAAP, Entity G measured identifiable assets and liabilities acquired in a business combination at:

- the acquirer's interest obtained in the exchange transaction; plus
- the NCI's portion of the pre-acquisition carrying amounts

Under IFRS 3, this treatment is not permitted. The Standard requires that assets and liabilities acquired in a business combination be measured at their values at the date of acquisition. Under IFRS 3(2008), there is a choice between measuring the NCI at either fair value or the NCI's proportionate share of the fair value of the net identifiable assets acquired.

Although the manner in which NCI was calculated under previous GAAP is not supportable under IFRSs, Entity G is not required to adjust the amount attributed to NCI at the date of transition.

Entity G has chosen not to restate business combinations that occurred before the date of transition to IFRSs; therefore, it need not adjust NCI to conform to the measurement basis under IFRS 3.

However, the requirements of IFRS 1 Appendix C may require some assets acquired, or liabilities assumed, in a business combination to be measured at amounts different from the carrying amounts immediately after the business combination under previous GAAP. In such circumstances, because the measurement of non-controlling interests follows the measurement of the other assets and liabilities, NCI will be adjusted for the effects of the differences.

### *4.1.7 Subsidiaries not consolidated under previous GAAP*

Under previous GAAP, an entity may not have consolidated a subsidiary acquired in a past business combination because, for example, it did not regard the investment as a subsidiary, or because the subsidiary was exempted from consolidation under previous GAAP, or because the entity did not prepare consolidated financial statements under previous GAAP. If a subsidiary has not previously been consolidated, at the date of transition the parent identifies the assets and liabilities of the subsidiary and adjusts the carrying amounts to the amounts that IFRSs would require in the subsidiary's separate financial statements.

The deemed cost of the goodwill relating to the previously unconsolidated subsidiary at the date of transition is calculated as the difference at the date of transition between:

- the parent's interest in the adjusted carrying amounts of the net assets of the subsidiary; and
- the cost in the entity's separate financial statements of its investment in the subsidiary.

The procedures for determining goodwill for a subsidiary that was not previously consolidated could lead to the recognition of a significant amount of goodwill if the subsidiary has, subsequent to the date of acquisition, reduced the carrying amount of net assets either by distribution of pre-acquisition reserves or by incurring significant losses. In all cases, goodwill recognised is tested for impairment at the date of transition.

If, on the other hand, the subsidiary has generated a significant amount of profit subsequent to acquisition, goodwill could be very limited. 'Negative goodwill' at the date of transition is recognised directly in retained earnings.

**Example – subsidiary not consolidated under previous GAAP**

Parent Company I's date of transition to IFRSs is 1 January 20X9. Under its previous GAAP, Parent Company I did not consolidate its 75 percent share of Subsidiary J, acquired in a business combination on 15 July 20X6. On 1 January 20X9:

(a) the cost of Parent Company I's investment in Subsidiary J is CU540 (based on the amount paid on acquisition); and

(b) under IFRSs, Subsidiary J would measure its assets at CU1,500 and its liabilities at CU900. On this basis, the net assets of Subsidiary J under IFRSs at the date of transition are CU600.

On transition to IFRSs, Parent Company I is required to consolidate Subsidiary J. The consolidated opening IFRS statement of financial position at 1 January 20X9 includes:

(a) the assets and liabilities of Subsidiary J at CU1,500 and CU900 respectively;

(b) non-controlling interests of CU150 (25 percent of [CU1,500 – CU900]);

(c) goodwill of CU90 (cost of CU540 less 75 percent of [CU1,500 – CU900]); and

(d) the resulting adjustment of CU540 (CU1,500 – CU900 – CU150 + CU90) recognised directly in retained earnings.

Parent Company I tests goodwill for impairment under IAS 36 *Impairment of Assets* and recognises any resulting impairment loss, based on conditions that existed at the date of transition.

### *4.1.8 Translation of goodwill and fair value adjustments arising in a business combination*

IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign operation to be treated as part of the assets and liabilities of the acquired entity and translated at the closing rate.

An entity may, under previous GAAP, have treated goodwill and/or fair value adjustments as assets and liabilities of the entity rather than as assets and liabilities of the foreign operation. If so, the entity is permitted to apply prospectively the requirements of IAS 21 to all acquisitions occurring after the date of transition. In other words, the entity need not apply IAS 21 retrospectively to goodwill and fair value adjustments arising in business combinations that occurred before the date of transition to IFRSs.

However, an entity may choose to apply IAS 21 retrospectively to goodwill and fair value adjustments arising in either:

(a) all business combinations that occurred before the date of transition; or

(b) all business combinations that the entity elects to restate to comply with IFRS 3.

**Example – treating goodwill relating to a foreign subsidiary as an asset of the acquirer**

Entity K has previously recognised goodwill relating to a foreign subsidiary arising on a business combination that occurred before the date of transition. Under previous GAAP, Entity K treated goodwill as its own asset and recognised goodwill in its functional currency based on the exchange rate at the date of acquisition.

On transition, Entity K is not required to restate the financial statements retrospectively to treat goodwill as an asset of the acquiree from the acquisition date and translate goodwill at the closing rate at the end of each reporting period.

When an entity does not apply IAS 21 retrospectively to goodwill, there are no further translation adjustments to the goodwill balance. Instead of treating goodwill as an asset of the acquiree and translating it at the end of each reporting period at the closing rate, the entity treats the goodwill balance as its own asset and recognises goodwill in its functional currency at the rate that was used under previous GAAP.

The exemption is not available for business combinations that occur after the date of transition. Therefore, for all acquisitions after the date of transition, IAS 21 must be fully complied with and goodwill must be treated as an asset of the acquiree.

### 4.1.9 Summary of the business combinations exemption

The decision to utilise the business combinations exemption on first-time adoption, and the point from which the exemption is applied, can have a substantial impact on an entity's first IFRS financial statements. The following summarises the key differences between using the exemption and restating business combinations to conform with the requirements of IFRS 3.

<table>
<tr><th>Subject</th><th>Optional exemption in IFRS 1 applied</th><th>IFRS 3 applied retrospectively</th></tr>
<tr><td>Classification</td><td>Keep the previous classification (acquisition/pooling of interests/reverse acquisition).</td><td>Identify the acquirer and the acquiree under IFRS 3.</td></tr>
<tr><td>Recognition</td><td>Identify assets and liabilities at the date of transition to IFRSs and:<br>• recognise assets and liabilities in compliance with IFRSs (except for some financial assets and liabilities derecognised under previous GAAP), which means that both recognition criteria – reliable measurement and probability – have to be met for all assets and liabilities;<br>• exclude assets and liabilities not complying with IFRSs.</td><td>Identify assets and liabilities at the date of acquisition and:<br>• recognise assets and liabilities in accordance with IFRS 3;<br>• exclude assets and liabilities not complying with IFRSs.</td></tr>
<tr><td>Measurement</td><td>Measurement basis other than cost:<br>• these assets and liabilities are measured on that basis at the date of transition, e.g. fair value.<br>Cost-based measured assets and liabilities:<br>• these assets and liabilities are measured at the carrying amount under previous GAAP immediately after the business combination less subsequent accumulated depreciation under IFRSs.<br>Assets and liabilities not recognised under previous GAAP:<br>• these assets and liabilities are measured as if the acquiree had adopted IFRSs retrospectively itself.</td><td>All identifiable assets and liabilities are:<br>• measured in accordance with IFRS 3 (most at fair value at the date of acquisition) and adjusted subsequently in compliance with relevant IFRSs.</td></tr>
<tr><td>Measurement of goodwill</td><td>Keep carrying amount of goodwill at the date of transition, except adjust for:<br>• recognition/non-recognition of intangible assets at the date of transition; and<br>• impairment of goodwill.<br>Goodwill deducted from equity under previous GAAP remains deducted from equity at the date of transition.</td><td>• Goodwill is determined at the date of acquisition in accordance with IFRS 3.<br>• This will be likely to cause adjustment to the carrying amount of any recognised goodwill under previous GAAP, including reversals of goodwill previously deducted from equity.<br>• Reverse previous goodwill amortisation.</td></tr>
<tr><td>Subsidiaries not previously consolidated</td><td>Recognise and measure assets and liabilities at the date of transition as if the subsidiary always has applied IFRSs. Determine goodwill at the date of transition as the difference between:<br>• the parent's interest in those adjusted carrying amounts; and<br>• the cost of the investment in the subsidiary.</td><td>Apply the general rules as stated above.</td></tr>
</table>

### *4.1.10 IFRS 3(2004)*

As noted earlier, this guide assumes that the reader is applying IFRS 3(2008); if this is not the case (i.e. the reader is applying IFRS 3 (2004)), the implications on first-time adoption differ in certain circumstances.

The majority of the guidance earlier in this section is equally applicable to entities applying IFRS 3(2004). The following table lists key areas where the application of the business combination exemption differs if IFRS 3(2004) is being used.

| Differences if IFRS 3(2004) is applied upon transition to IFRSs | |
|---|---|
| **Issue** | **Guidelines** |
| Under the optional exemption for business combinations, goodwill should be adjusted for contingencies that affect the amount of purchase consideration. | However, goodwill is only adjusted if:<br>• the contingent adjustment has been resolved and settled before the date of transition but has not been reflected in the amount of goodwill under previous GAAP;<br>• a reliable estimate of the contingent adjustment can be made and its payment is probable; or<br>• a previously recognised contingent adjustment can no longer be measured reliably or its payment is no longer probable. |
| Goodwill deducted from equity under previous GAAP. | Under IFRS 3(2004), subsequent adjustments to goodwill previously deducted from equity arising due to the resolution of a contingency affecting the purchase consideration are recognised in retained earnings. The same applies to intangible assets subsumed within goodwill and intangible assets not qualifying for recognition under IFRSs. |
| Non-controlling interests (NCI) – known as 'minority interests' in IFRS 3(2004). | Under IFRS 3(2004), NCI will be stated at the NCI's proportionate share of the fair value of the net identifiable assets. This differs from IFRS 3(2008) where there is a choice between measuring the NCI at either fair value or the NCI's proportionate share of the fair value of the net identifiable assets of the entity acquired. |

Readers who are applying IFRS 3(2004) on first-time adoption should consider consulting with a Deloitte professional for further information.

## 4.2 Share-based payment transactions

Relevant IFRSs: IFRS 2 *Share-based Payment*

IFRS 2 deals with the accounting and disclosure requirements related to share-based payment transactions. The Standard addresses situations where an entity grants shares or share options to employees or other parties providing goods or services. IFRS 2 requires these share-based payments to be recognised as an expense. The amount recognised as an expense is measured at the fair value of the goods or services received unless, for equity-settled transactions, that fair value cannot be measured reliably. In these cases, which are deemed to include employee share options, the fair value of the equity instruments granted should be measured. This amount is allocated over the vesting period, if any, attached to the scheme or otherwise is recognised immediately.

The Standard addresses three types of share-based payment transactions: equity-settled, cash-settled, and with cash-alternatives. Equity-settled transactions are measured at fair value at grant date only. Cash-settled transactions are measured at fair value at the end of each reporting period until exercised. Cash-alternative transactions are measured partly as equity-settled and partly as cash-settled transactions.

IFRS 2 contains various transitional provisions. The IASB decided that, in general, first-time adopters should be treated in the same way as entities already applying IFRSs in this regard. The exemptions set out below reflect that principle.

### *4.2.1 Equity-settled transactions*

IFRS 1 includes two exemptions for equity-settled transactions:

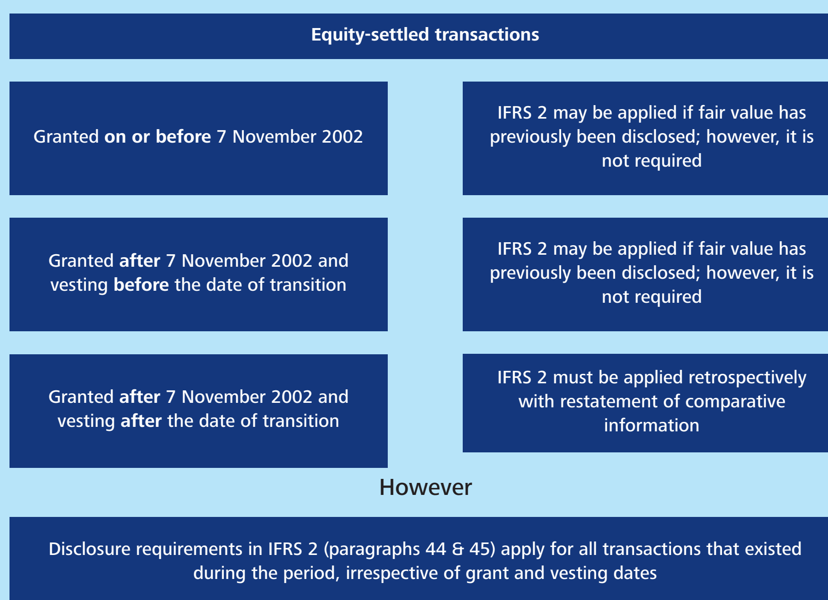
- first-time adopters are not required to apply IFRS 2 for equity-settled share-based payments granted on or before 7 November 2002; and
- first-time adopters are not required to apply IFRS 2 to share-based payments granted after 7 November 2002 that vested before the date of transition to IFRSs.

The second bullet above should technically refer to share-based payments granted after 7 November 2002 that vested before the later of (a) the date of transition to IFRSs and (b) 1 January 2005. The reference to 1 January 2005 is assumed to be redundant for the purposes of this guide and is ignored for the remainder of this section.

If a first-time adopter elects to apply IFRS 2 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date as defined in IFRS 2.

The effect of this requirement is to prohibit full retrospective application of IFRS 2 by many entities because they will not have disclosed publicly the fair value of the equity instruments granted in previous years. The Standard does not elaborate on what is meant by 'disclosed publicly' but it appears that the IASB had in mind disclosure in the financial statements in the year when the instruments were granted. Paragraph IG8 in the Implementation Guidance to IFRS 2 gives, as an example, disclosures made in the notes to the financial statements of the information required in the US by SFAS 123. Although the Basis for Conclusions to IFRS 2 does not explain the reasons for the effective prohibition on full retrospective application, it appears that this was due to concerns about the difficulty of obtaining valuations at earlier dates without being influenced by the benefit of hindsight. Therefore, although the letter of the requirement to have publicly disclosed the fair values might be met in other ways (e.g. in a press release prior to the first IFRS financial statements), it is clear that only contemporaneous disclosure in the financial statements would meet the intentions of the Standard.

**First-time adoption of IFRS 2**




**Example – transition to IFRS 2 for first-time adopter in 20X5**

Company L is a first-time adopter of IFRSs with a reporting date of 31 December 20X5 and a date of transition of 1 January 20X4. Company L has historically granted share-based payments to employees. Some, but not all, of these grants have vested by 1 January 20X4. How should Company L account for its share-based payment transactions on first-time adoption?

Company L is required to apply IFRS 2 fully for all share-based payment transactions that were granted after 7 November 2002 and that have not vested at 1 January 20X4. For share-based payment transactions granted before 7 November 2002, or granted after 7 November 2002 but vested before 1 January 20X4, Company L is not required to apply IFRS 2, but may choose to do so if the fair value of those share-based payments was previously disclosed. The fair value must have been determined at the grant date, in accordance with IFRS 2.

Considerable judgement will be required to determine the appropriate valuation of these share-based payment transactions retrospectively if valuations were not previously obtained. IFRS 1 provides some guidance in relation to estimates and restrictions on the use of hindsight, which is useful to the fair value measurement of equity-settled transactions.

**Example – measurement of equity-settled share-based payment on first-time adoption of IFRSs**

Company M is adopting IFRSs for the first time with a date of transition of 1 January 20X4 and a reporting date of 31 December 20X5. Company M issued share options on 30 June 20X3 (which was after 7 November 2002) that vest after four years (i.e. on 30 June 20X7). The transaction is classified as equity-settled. Under Company M's previous GAAP, Company M did not estimate (or disclose) the fair value of the share options determined as at 30 June 20X3 in accordance with IFRS 2.

Company M is required to apply IFRS 2 to the June 20X3 grant of share options. As estimates of fair value were not required under previous GAAP, the measurement should reflect conditions at the date of transition to IFRSs. Company M should use information available at 1 January 20X4 to determine expected volatility, expected dividends, and the expected life of the options under the equity-settled transaction. However, some inputs to the valuation model are based purely on contractual or historical fact; in which case, that historical information should be used. Therefore, the share price, exercise price and risk-free rate should be based on information available at grant date – in this case 30 June 20X3.

### *4.2.2 Cash-settled transactions*

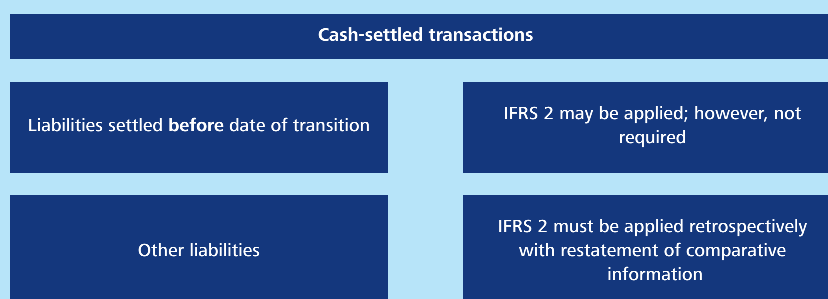
A first-time adopter is encouraged, but not required, to apply IFRS 2 to liabilities arising from share-based payment transactions that were settled before the later of:

- the date of transition to IFRSs; and
- 1 January 2005.

This exemption is of limited relevance today compared to when it was first introduced. The date of transition to IFRSs will invariably be later than 1 January 2005 so the practical effect is that liabilities can be ignored if they were settled before the date of transition to IFRSs. Such liabilities would have no effect on the financial statements even if an exemption did not exist. For the remainder of this section, the reference to 1 January 2005 is ignored.

For liabilities to which IFRS 2 is applied, a first-time adopter is not required to restate comparative information to the extent that the information relates to a period or date that is earlier than 7 November 2002.

**First-time adoption of IFRS 2**




As for equity-settled transactions, considerable judgement is required to determine the fair value in accordance with IFRS 2 of cash-settled share-based payment transactions. New methods and models may be introduced upon transition to IFRSs as IFRS 2 requires the use of an option pricing model and provides some guidance on determining the inputs to that model.

**Example – measurement of cash-settled share-based payments on first-time adoption of IFRSs**

Company N is adopting IFRSs for the first time with a date of transition of 1 January 20X4 and a reporting date of 31 December 20X5. Company N issued share options on 30 November 20X2 that do not vest until 30 November 20X6. The share options will be settled in cash. The vesting conditions are related to continued employment only. In accordance with IFRS 1, Company N is required to apply IFRS 2 to the November 20X2 grant of share options because the liability is not settled before the date of transition. Under previous GAAP, Company N had not estimated (or disclosed) fair value determined as at 30 November 20X2 in accordance with IFRS 2; however, it recognised and measured the liability in its previous GAAP financial statements at the difference between the exercise price and the current share price at 31 December 20X2.

At the date of transition (1 January 20X4) and at each reporting date until it is settled, Company N measures the liability at its fair value, by applying an option pricing model, taking into account the terms and conditions on which the share options were granted, and the extent to which the employees have rendered service to date. The fair value of the cash-settled share-based payments includes both intrinsic value and time value. Time value is in this context defined as "…the value of the right to participate in future increases in the share price, if any, that may occur between the valuation date and the settlement date". The exclusion of the time value would lead to an inadequate measure of the liability.

The amount recognised under previous GAAP at 31 December 20X2, which was based on the difference between the exercise price and the current share price at 31 December 20X2, cannot be used as an approximation to fair value of the options under IFRS 2 at 1 January 20X4.

### *4.2.3 Modifications to existing share-based payment arrangements*

If a first-time adopter modifies the terms or conditions of a grant of equity instruments to which IFRS 2 has not been applied, the requirements of IFRS 2 regarding the treatment of such modifications need not be applied if the modifications occurred before the date of transition to IFRSs.

### *4.2.4 Disclosure requirements – equity-settled transactions*

Irrespective of the grant dates and vesting dates of a first-time adopter's equity-settled share-based payment transactions, the entity is required to disclose information that enables the users to understand the nature and extent of share-based payment arrangements that existed during the period. For a first-time adopter, this includes providing a limited (but nevertheless significant) number of disclosures for all equity-settled transactions that existed during the period covered by its first IFRS financial statements. The first-time adopter is required to provide a description of:

- each type of share-based payment arrangement, including settlement method (whether in equity or cash) and vesting conditions;
- the number and weighted average exercise prices of share options outstanding by way of a reconciliation of changes for the period;
- the weighted average share price at date of exercise for share options exercised during the period; and
- for share options outstanding at the end of the period, the range of exercise prices and weighted average remaining contractual life.

Furthermore, the first-time adopter should – for equity-settled transactions falling within the scope of IFRS 2 – disclose more detailed information that enables the users to understand how the fair value was determined, and how the share-based payment transactions recognised affected profit or loss for the period and the financial position of the first-time adopter.

## 4.3 Insurance contracts

Relevant IFRSs: IFRS 4 *Insurance Contracts*

IFRS 4 was issued in 2004 and is seen as an interim Standard pending completion of the IASB's project on insurance contracts. IFRS 4 allows entities to continue to use their existing accounting policies for liabilities arising from insurance contracts as long as the existing policies meet certain minimum requirements as set out in IFRS 4. IFRS 4 also requires disclosures that identify and explain the amounts in an insurer's financial statements arising from insurance contracts.

The IASB recognised that it could be quite onerous for entities to apply the requirements of IFRS 4 retrospectively. Therefore, IFRS 1 provides an optional exemption whereby an entity issuing insurance contracts (an insurer) may elect upon first-time adoption to apply the transitional provisions of IFRS 4 *Insurance Contracts*.

These transitional provisions require an insurer to apply IFRS 4 prospectively for reporting periods beginning on or after 1 January 2005, with earlier application permitted. While this may have represented significant relief for entities that adopted IFRSs in 2005, its benefit for the 'second wave' of adopters is primarily in restricting the amount of retrospective application required (i.e. from 2005 to date of transition).

One specific area of relief that continues to benefiit first-time adopters is in the application of IFRS 4.39(c)(iii) (comparison of actual claims with previous estimates), when first-time adopters are not required to disclose information about claims development that occurred earlier than five years before the end of the first financial year in which they apply IFRS 4. Furthermore, if it is impracticable when an entity first applies IFRS 4 to prepare information about claims development that occurred before the beginning of the earliest period for which the entity presents full comparative information that complies with IFRS 4, that fact is to be disclosed.

In addition, when an insurer changes its accounting policies for insurance liabilities, it is permitted, but not required, to reclassify some or all of its financial assets as 'at fair value through profit or loss'. This reclassification is permitted:

- if an insurer changes accounting policies when it first applies IFRS 4 (e.g. on first-time adoption); and
- if it makes a subsequent policy change permitted by IFRS 4.22, in which case the reclassification is a change in accounting policy and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* applies.

## 4.4 Deemed cost

Relevant IFRSs: IAS 16 *Property, Plant and Equipment*
IAS 40 *Investment Property*
IAS 38 *Intangible Assets*

In drafting IFRS 1, the IASB acknowledged that the costs of requiring entities to reconstruct cost information or other transactional data for property, plant, and equipment and other long-term assets could be particularly onerous when entities might not have retained the necessary historical information. The IASB also noted that reconstructed data might be less relevant to users, and less reliable than current fair value data. As a result, IFRS 1 includes an optional exemption that relieves first-time adopters from the requirement to recreate cost information for property, plant and equipment, investment property and intangible assets. When the exemption is applied, deemed cost is the basis for subsequent depreciation and impairment tests. Deemed cost as defined by IFRS 1 as "the amount used as a surrogate for cost or depreciated cost at a given date".

### *4.4.1 Scope of exemption*

The exemption (described in detail below) may be applied to:

- property, plant and equipment;
- investment property, if an entity elects to use the cost model in IAS 40 *Investment Property*; and
- intangible assets that meet:
  - the recognition criteria in IAS 38 *Intangible Assets* (including reliable measurement of original cost); and
  - the criteria in IAS 38 for revaluation (including the existence of an active market).

A further exemption relating to oil and gas assets was introduced in July 2009 (see **section 4.4.5**).

The exemption cannot be applied to other classes of assets by analogy. The exemption is available regardless of the IFRS accounting policy selected by the entity for ongoing reporting purposes.

The exemption may be used selectively within the classes of assets described. A first-time adopter need not use fair value as deemed cost for all assets in the same class. However, assets that are not restated must nevertheless be considered for impairment.

The ability to apply this exemption to intangible assets is likely to be of limited relevance given that IAS 38's restrictive criteria for use of the revaluation basis must be met.

The exemption also applies to assets held under finance leases and capitalised in the financial statements. A first-time adopter may therefore measure these items at fair value at the date of transition. However, the related finance lease liability is not measured at fair value; rather it is measured at the net present value of the lease payments (amortised cost under IAS 39).

### *4.4.2 Details of the exemption*

IFRS 1 permits any one of the following amounts to be used as the 'deemed cost' at the date of transition for any asset within the scope of the exemption:

a) fair value at date of transition to IFRSs; or

b) a revaluation under previous GAAP that meets specified criteria (see below); or

c) a deemed cost measurement recognised under previous GAAP based on fair value at the date of an event such as a privatisation or an initial public offering (an 'event-driven' value).

Subsequent depreciation is based on the deemed cost and starts from the date at which the fair value measurement or revaluation was established (which in the case of (b) or (c) above will be before the date of transition).

The option to use a previous GAAP valuation under (b) above is only available if the revaluation was, at the date of the revaluation, broadly comparable to:

- fair value; or
- cost or depreciated cost under IFRSs, adjusted to reflect, for example, changes in a general or specific price index.

The option to use an event-driven value under (c) above is only available if that value was recognised in the entity's financial statements under previous GAAP.

**Example – election to use fair value or revalued amount**

Company O acquires a factory building for CU360 on 1 January 20X7 with an expected remaining useful life of 40 years at that date. The building is revalued on 1 January 20X8 to CU390 and the resulting adjustment is recognised in equity. The building has a depreciated carrying amount of CU351 on 1 January 20X8 and CU380 on 1 January 20X9. The depreciation method under previous GAAP is acceptable under IAS 16 and the revaluation is broadly comparable to fair value at the date of revaluation.

Company O selects the cost model as its accounting policy for measurement after recognition of buildings in accordance with IAS 16. Company O has a date of transition of 1 January 20X9. At 1 January 20X9, the building has a market value of CU415. Company O has an option to measure the building at (a) fair value at the date of transition, (b) the previous GAAP revaluation, or (c) to apply IAS 16 retrospectively. The following journal entries are required in each instance.

| | CU | CU |
|---|---|---|
| *(a) Fair value at 1 January 20X9* | | |
| Dr. Factory building [CU415 – CU380] | 35 | |
| Cr. Retained earnings | | 35 |
| *Adjustment of carrying amount to fair value as deemed cost* | | |
| Dr. Revaluation surplus [CU390 – CU351] | 39 | |
| Cr. Retained earnings | | 39 |
| *Reversal of original revaluation at 1 January 20X8* | | |
| *(b) No journal entry is required as the carrying amount under previous GAAP is acceptable under IAS 16.* | | |
| *(c) Retrospective application of IAS 16* | | |
| Dr. Revaluation surplus [CU390 – CU351] | 39 | |
| Cr. Factory building [CU390 – CU360] | | 30 |
| Cr. Accumulated depreciation | | 9 |
| *Reversal of original revaluation at 1 January 20X8* | | |
| Dr. Accumulated depreciation [(CU390 x 1/39) – (CU360 x 1/40)] | 1 | |
| Cr. Retained earnings | | 1 |
| *Reversal of additional depreciation on revaluation at 1 January 20X9* | | |

### *4.4.3 Assets acquired in a business combination*

For assets previously acquired in a business combination, when the entity has elected not to apply IFRS 3 retrospectively (see **section 4.1** above), the accounting will vary according to whether the item was recognised under previous GAAP.

#### 4.4.3.1 IFRS 1, Appendix C – Property, plant and equipment, investment property and intangible assets recognised under previous GAAP

Under IAS 40, a first-time adopter may elect to measure investment property at fair value. If the entity makes this election, it applies fair value measurement to all investment property. Fair value under this election is determined at the date of transition and in accordance with any related guidance in IFRSs for the item in question.

Items carried at cost under previous GAAP which satisfy the criteria for recognition in the relevant IFRSs have a deemed cost under IFRSs equal to the cost of the item under previous GAAP immediately subsequent to acquisition. The first-time adopter determines the appropriate depreciation expense under IFRSs from acquisition date up until the date of transition. If that amount is materially different from the amount recognised under previous GAAP, that difference is recognised in retained earnings at the date of transition.

A first-time adopter has an option to (a) use the carrying amount immediately subsequent to acquisition and determine the appropriate depreciation expense under IFRSs to the date of transition or (b) measure at fair value at the date of transition. If the entity elects the fair value model for investment property, it measures these items at fair value at the date of transition. In all instances, the resulting adjustment is recognised in retained earnings.

**Example – tangible asset acquired in a business combination and recognised under previous GAAP**

Parent P acquired Subsidiary Q on 1 January 20X6. As part of the business combination, it acquired and recognised a shipping vessel at fair value of CU6,000. The vessel had a remaining useful life of 12 years at the date of acquisition of Subsidiary Q. The vessel was revalued on 1 January 20X8 to fair value of CU6,500 and the resulting adjustment was recognised in equity. The carrying amount on 1 January 20X9 determined under an IAS 16 compliant revaluation policy is CU5,850. Parent P has selected as its accounting policy to measure shipping vessels after recognition under the cost model in IAS 16. The fair value of the vessel is CU7,000 on 1 January 20X9.

Parent P has a date of transition of 1 January 20X9. Parent P has an option to measure the shipping vessel at (a) fair value at the date of transition, (b) the previous GAAP revaluation or (c) carrying amount immediately after acquisition. The following journal entries are required in each instance.

| | CU | CU |
|---|---|---|
| *(a) Fair value at 1 January 20X9* | | |
| Dr. Shipping vessel [CU7,000 – CU5,850] | 1,150 | |
| Cr. Retained earnings | | 1,150 |
| *(b) No journal entry is required as the carrying amount under previous GAAP is acceptable under IAS 16* | | |
| *(c) Carrying amount immediately after the date of acquisition* | | |
| Dr. Revaluation reserve [CU6,500 – CU5,000] | 1,500 | |
| Cr. Shipping vessel | | 1,500 |
| *Reversal of original revaluation at 1 January 20X8* | | |
| Dr. Accumulated depreciation [CU1,500 x 1/10] | 150 | |
| Cr. Retained earnings | | 150 |
| *Reversal of additional depreciation arising on revaluation* | | |

#### 4.4.3.2 IFRS 1, Appendix C – Property, plant and equipment, investment property and intangible assets not recognised under previous GAAP

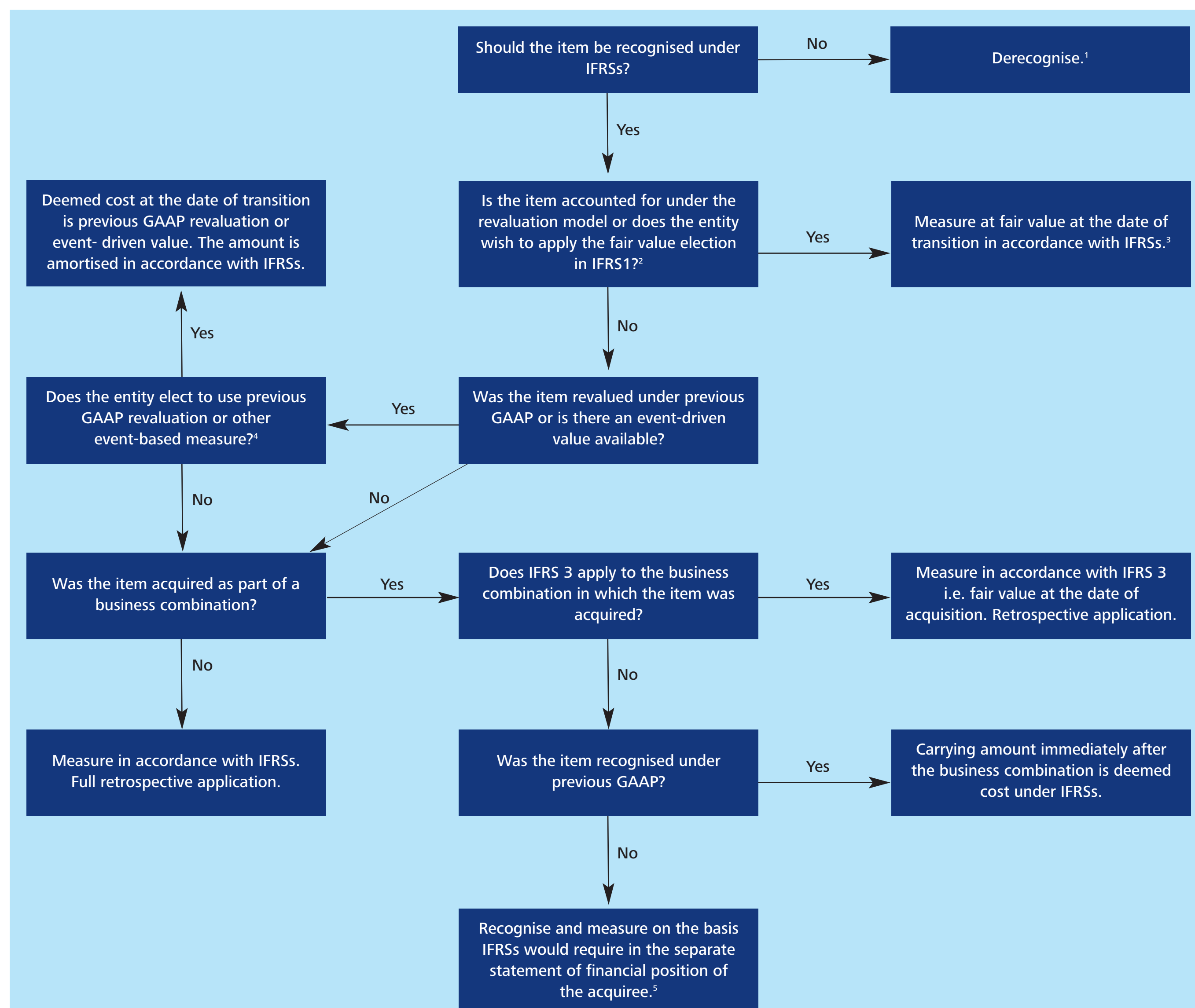
Items not recognised under previous GAAP do not have a cost of nil at the date of transition. IFRS 1 effectively requires retrospective application of IFRSs in these circumstances because these items are measured on the basis they would have been recognised in the separate financial statements of the subsidiary under IFRSs. Resulting adjustments are recognised in retained earnings at the date of transition. A first-time adopter may still apply the deemed cost election available under IFRS 1 to assets acquired in a business combination.

#### 4.4.3.3 Retrospective application of IFRS 3

If a first-time adopter elects to apply IFRS 3 retrospectively, all items of property plant and equipment, investment property and intangible assets should be measured in accordance with that Standard from the date of acquisition.

### 4.4.4 Decision tree for property, plant and equipment, intangible assets and investment property

The following illustration highlights the key decisions to be made for property, plant, and equipment, intangible assets and investment property.




1 Where the item being derecognised is an intangible asset acquired in a business combination, the resulting adjustment is recognised in goodwill. Otherwise the adjustment is recognised in retained earnings.

2 The election can be applied for intangible assets only where the recognition and revaluation criteria in IAS 38 are satisfied (including existence of an active market).

3 For items accounted for under the cost model, the fair value at transition date is deemed cost under IFRSs. Subsequent measurement is determined in accordance with the applicable IFRS. Where the item being measured at fair value is an intangible asset that was acquired in a business combination and was previously subsumed in goodwill, the fair value at the date of transition is adjusted against goodwill.

4 This option is only available if the previous GAAP revaluation was broadly comparable, at the date of revaluation, to fair value, cost or depreciated cost under IFRSs, adjusted to reflect, for example, changes in a general or specific price index. If the entity takes this option, the carrying amount is the deemed cost at revaluation date depreciated in accordance with IFRSs to the date of transition. An entity may also elect to use an event-driven value if that value was based on fair value and it was recognised under previous GAAP.

5 Where the item being recognised is an intangible asset that was previously subsumed in goodwill, the resulting change should be recognised in goodwill. In all other cases, the resulting change should be recognised in retained earnings.

### 4.4.5 Exemption for oil and gas assets

In July 2009, the IASB added a new exemption to deal specifically with oil and gas assets. For the purposes of this exemption, the term 'oil and gas assets' is limited to those assets used in the exploration and evaluation (IFRS 6) or development and production (IAS 38) of oil and gas.

Under some local GAAPs, exploration and development costs for oil and gas properties in the development or production phases are accounted for in cost centres that include all properties in a large geographical area (known as the 'full cost' method).

IFRS 1 permits a first-time adopter that has previously used this basis of accounting to elect to measure the related oil and gas assets at the date of transition to IFRSs on the following basis:

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

(b) oil and gas assets in the development or production phases at the amount determined for the cost centre under the entity's previous GAAP allocated to the cost centre's underlying assets pro rata using reserve volumes or reserve values as of that date.

Entities electing to use the exemption are required to test both exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition to IFRSs. The exploration and evaluation assets are tested in accordance with IFRS 6 *Exploration for and Evaluation of Mineral Resources* and development and production assets are tested in accordance with IAS 36 *Impairment of Assets*.
Any identified impairment losses must be recognised at the date of transition.

This exemption is effective for annual periods beginning on or after 1 January 2010, with earlier application permitted. If this exemption is applied for a period beginning before 1 January 2010, that fact must be disclosed.

## 4.5 Leases

Relevant IFRSs: IAS 17 *Leases*
SIC-15 *Operating Leases – Incentives*
IFRIC 4 *Determining whether an Arrangement contains a Lease*

There are no explicit exemptions or exceptions in IFRS 1 from retrospective application of IAS 17 *Leases*. A first-time adopter is therefore required to recognise all assets held under finance lease at the date of transition. If not previously recognised, this involves determining the fair value of the asset at inception of the lease (or the present value of the minimum lease payments, if lower) depreciated to the date of transition and calculating the finance lease liability based on the net present value of the minimum lease payments, amortised using the rate implicit in the lease (or, in certain circumstances, the lessees' incremental borrowing rate). It may be difficult and even impracticable to determine the fair value of the asset acquired in the lease; however, the entity may elect to measure the asset capitalised under a finance lease at fair value at the date of transition in accordance with the optional exemption in IFRS 1 (see **section 4.4.1**).

**Example – finance lease not capitalised under previous GAAP**

Company Q (the lessee) entered into a three-year lease agreement on 1 January 20X1. The lease rental is CU5,000 per annum. Company Q has guaranteed a CU1,000 residual value at 31 December 20X3 to the lessor. The leased asset is expected to have a CU100 residual value at the end of the lease term. The fair value of the asset at the date it was acquired by the lessee was CU13,184. The rate implicit in the lease is therefore 10%. Under previous GAAP, the lease rentals were expensed as incurred. The lease is classified as a finance lease under IFRSs. Company Q has a date of transition of 1 January 20X2. Company Q should account for the finance lease as follows at the date of transition.

Amortisation of the lease obligation (in CU):

| Date | Lease rental | Interest expense | Reduction in lease obligation | Lease obligation |
|---|---|---|---|---|
| 1 January 20X1 | | | | 13,184 |
| 31 December 20X1 | 5,000 | 1,319 | 3,681 | 9,503 |
| 31 December 20X2 | 5,000 | 951 | 4,049 | 5,454 |
| 31 December 20X2 | 5,000 | 546 | 4,454 | 1,000 |

Amortisation (CU13,184 – CU100) / 3 = CU4,362 per year

The following journal entries are required at the date of transition 1 January 20X2 (in CU).

| | | |
|---|---|---|
| Dr. Finance lease asset | 13,184 | |
| Dr. Retained earnings | 681 | |
| Cr. Accumulated depreciation (1 year) | | 4,362 |
| Cr. Liability under finance lease | | 9,503 |

#### *4.5.1 Determining whether an arrangement contains a lease*

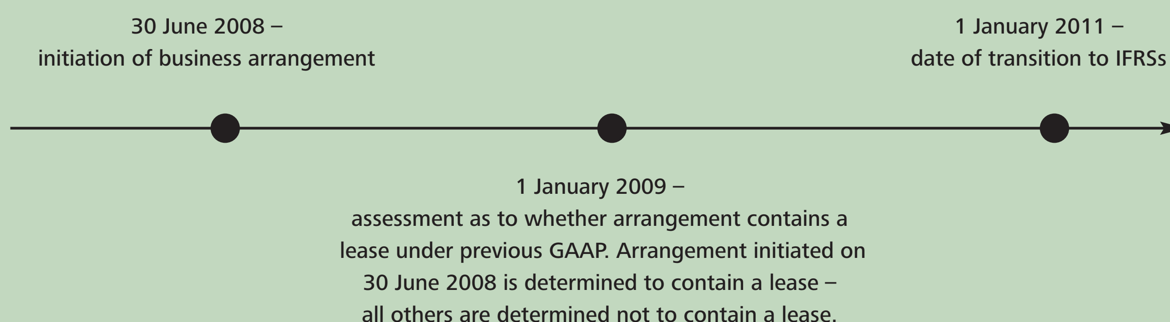
IFRIC 4 specifies criteria for determining, at the inception of an arrangement, whether the arrangement contains a lease. It also specifies when an arrangement should be reassessed subsequently. IFRS 1 provides an exemption from these requirements. Instead of determining retrospectively whether an arrangement contains a lease at the inception of the arrangement and subsequently reassessing that arrangement as required in the periods prior to transition to IFRSs, entities may determine whether arrangements in existence on the date of transition to IFRSs contain leases by applying paragraphs 6 to 9 of IFRIC 4 to those arrangements on the basis of the facts and circumstances existing at the date of transition.

In 2009, an additional exemption was added to provide further relief to certain first-time adopters. The new exemption applies to a first-time adopter that, under its previous GAAP, has made an assessment as to whether an arrangement contains a lease at a date other than that required under IFRIC 4. Following adoption of the exemption, such a first-time adopter is not required to reassess its previous determination if that previous determination under its previous GAAP would have given the same outcome under IAS 17 and IFRIC 4. This new exemption is effective for annual periods beginning on or after 1 January 2010, with earlier application permitted.

**Example – additional exemption from reassessment as to whether an arrangement contains a lease**

Entity R is adopting IFRSs with a date of transition of 1 January 2011. Effective 1 January 2009, Entity R's previous GAAP was amended to include guidance relating to whether an arrangement contains a lease. At the time the previous GAAP requirement became effective, Entity R assessed that it had only one arrangement which contained a lease. The arrangement was entered into on 30 June 2008 and remains outstanding at the date of transition to IFRSs.

Entity R has determined that the assessment it performed under prevous GAAP (i.e. whether the arrangement contained a lease) resulted in the same outcome that would have resulted under IFRIC 4.




With the new exemption, upon adoption of IFRSs, Entity R is not required to reassess whether existing arrangements contain a lease. Instead, Entity R can rely on the assessment made under previous GAAP as long as the assessment would have provided the same outcome as under IAS 17 and IFRIC 4.

## 4.6 Employee benefits

Relevant IFRSs: IAS 19 *Employee Benefits*

Note: The following analysis applies for entities that have chosen to recognise actuarial gains and losses using IAS 19's 'corridor' approach. Other alternatives are available under IAS 19 – including immediate recognition of actuarial gains and losses in other comprehensive income (see IAS 19 for details).

Under IAS 19's requirements for measuring the liability for defined benefit post-employment benefit plans, actuarial gains and losses are not necessarily recognised in profit or loss immediately. Where entities make the relevant accounting policy selection, the minimum requirement is that actuarial gains and losses outside a pre-determined range (referred to as the 'corridor') are recognised in profit or loss in future periods over the expected average remaining working lives of the employees participating in the plan. Actuarial gains and losses within the corridor need not be recognised – although the entity may choose to do so.

Retrospective application of the corridor approach would require cumulative actuarial gains and losses from the inception of each defined benefit plan to be determined and split between recognised and unrecognised gains and losses at the end of each reporting period in accordance with IAS 19. This would in most cases be impracticable unless the entity has applied similar accounting under previous GAAP.

IFRS 1 therefore permits an entity to elect to recognise all cumulative actuarial gains and losses up to the date of transition. If the entity chooses this exemption, it is required to apply it for all defined benefit plans. When the exemption is utilised, an entity is not precluded from applying the 'corridor' approach for actuarial gains and losses which arise after the date of transition.

Where the exemption is availed of, the corridor must be reset at the date of transition; entities are not permitted to select any other date.

This optional exemption may result in a significant adjustment to total equity at the date of transition, but as a result the first-time adopter avoids amortising the accumulated losses in profit or loss after transition. Only those actuarial gains and losses arising subsequent to the date of transition will be recognised in profit or loss.

It is likely that most first-time adopters applying the corridor approach will make use of the election to recognise all cumulative actuarial gains and losses at the date of transition; this means that the full amount of the surplus or deficit is recognised at the date of transition to IFRSs (subject to the detailed requirements of IAS 19).

If this exemption is not availed of, it would be necessary to go back to the inception of the pension scheme (or, if later, the date on which the scheme was acquired in a business combination) and obtain actuarial valuations at the end of each subsequent reporting period to apply the corridor approach with retrospective effect. For a pension scheme that has been established for more than a few years, this is likely to involve significant cost and may be impracticable.

#### *4.6.1 Subsidiary adopts IFRSs before parent*

If the parent becomes a first-time adopter later than its subsidiary and the subsidiary has made an unreserved statement of compliance with IFRSs in previous years, that subsidiary's defined benefit corridor cannot be reset to zero for the purposes of the consolidated financial statements. This is because, if the parent adopts IFRSs later than its subsidiary, it must use that subsidiary's date of transition as its own for that subsidiary. This is the exception to the rule that the corridor amount for all plans must be reset to zero.

#### *4.6.2 Defined benefit plan assumed in a business combination*

If a defined benefit plan was assumed as part of a business combination, the plan is only brought into the consolidated entity from the date of acquisition. At the date of acquisition, the plan has a new measurement basis as required by IFRS 3. Also, Example 2 in the IFRS 1 Implementation Guidance clarifies that the pension obligation and corresponding adjustment to retained earnings are calculated from the date of acquisition. An entity is not permitted to restate a plan prior to the date the plan was assumed in a business combination.

#### *4.6.3 Exemption from a disclosure requirement in IAS 19*

IAS 19 includes a requirement to disclose the following amounts for the current annual period and the previous four annual periods:

- the present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit in the plan;
- the experience adjustments arising on the plan liabilities expressed either as an amount or as a percentage of plan liabilities at the end of the reporting period; and
- the experience adjustments arising on the plan assets expressed either as an amount or as a percentage of plan assets at the end of the reporting period.

To be consistent with the transitional rules for this requirement in IAS 19, IFRS 1 allows that a first-time adopter may disclose these amounts as they are determined for each accounting period prospectively from the transition date.

**Example – previous GAAP similar to IAS 19**

In Country O, a local standard on employee benefits became effective for annual financial periods beginning on or after 1 January 20X2 with the possibility of earlier application. The local standard is similar to IAS 19. Company S chose to adopt this standard early in its previous GAAP financial statements and applied it from 1 January 20X1, using the 'corridor' approach for defined benefit liabilities from that date.

Under the local standard, Company S recognised the net defined benefit liability at 1 January 20X1 without any deferrals, corridors etc.; however, a new corridor effect will arise during 20X1 and 20X2.

Company S will be a first-time adopter in 20X3 and has made an accounting policy choice to apply IAS 19's corridor approach. Under IFRS 1, paragraph D10, a first-time adopter has only two choices regarding defined benefit liabilities:

i) either reset the corridor at the date of transition; or

ii) retrospective application of IAS 19 and thus calculation of the corridor each year from the inception of the plan.

Therefore, if Company S wishes to maintain the carrying amount of the defined benefit liability determined under previous GAAP (i.e. the corridor set to zero at 1 January 20X1 and not at 1 January 20X2), Company S's date of transition must be 1 January 20X1. If 1 January 20X2 is the date of transition, the net liability will have to be recalculated once again as of this date, thereby eliminating the 20X1 corridor effect against retained earnings.

### *4.6.4 Unrecognised past service costs*

Past service cost is the change in the defined benefit obligation for employee service in prior periods arising as a result of changes to plan arrangements in the current period. Under IAS 19, past service cost is recognised immediately to the extent it relates to former employees or to active employees already vested. Otherwise, it is amortised on a straight-line basis over the average period until the amended benefits become vested.

IFRS 1 grants no exemption from the requirement to identify and amortise the unvested past service cost at the date of transition. This requirement is, however, considerably less onerous than the retrospective application of the 'corridor' for actuarial gains and losses because it does not require the re-creation of data since the inception of the plan.

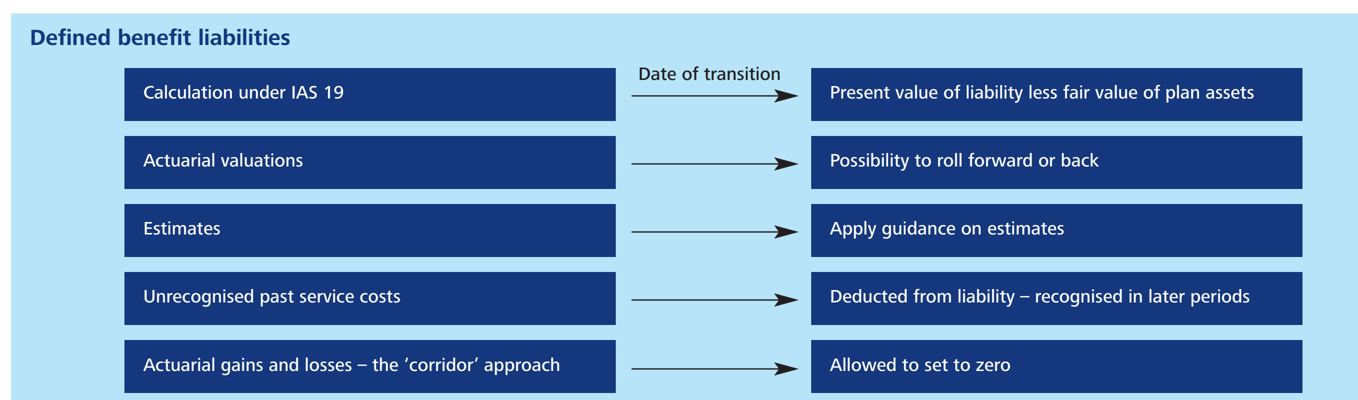
### *4.6.5 Actuarial valuations*

Generally, an entity's first IFRS financial statements reflect measurements of defined benefit obligations at three different dates: the reporting date, the end of the comparative financial year and the date of transition. First-time adopters are encouraged, but not required, to involve a qualified actuary in the valuations. An entity may base all these measurements on a full actuarial valuation at one of these dates only, and roll that valuation forward or back to the other dates, provided that any such roll forward or roll back reflects material transactions and events (including changes in market prices and interest rates) between those dates.

### *4.6.6 Estimates*

After any adjustments to reflect changes in accounting policies for defined benefit obligations, the first-time adopter should ensure that the actuarial assumptions at the date of transition are consistent with the actuarial assumptions made for the same date under previous GAAP, unless there is objective evidence that those assumptions were in error. If certain actuarial assumptions were not made under previous GAAP, IFRS 1 requires that these assumptions should reflect the conditions at the date of transition, e.g. in relation to discount rates and the fair value of plan assets. Changes in actuarial assumptions that occur after the date of transition are not reflected in the measurement of the defined benefit liabilities at the date of transition.

The following illustration summarises some of the key aspects of the employee benefits exemption.



## 4.7 Cumulative translation differences

Relevant IFRSs: IAS 21 *The Effects of Changes in Foreign Exchange Rates*
IAS 27 *Consolidated and Separate Financial Statements*

On translation of a foreign operation in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rate*s, certain exchange differences are recognised as a separate component of equity. On subsequent disposal of the foreign operation, the accumulated translation differences related to the specific foreign operation are recognised in profit or loss for the period as part of the gain or loss on disposal.

Retrospective application of IAS 21 could be very onerous for a first-time adopter as it would require an entity to retrospectively determine the translation differences arising on the translation of the financial results of the foreign operation in accordance with IFRSs since the date on which the operation was formed or acquired. Often this information will not be readily available. IFRS 1 provides an optional exemption relating to the treatment of cumulative translation differences upon first-time adoption.

A first-time adopter may elect not to calculate the translation difference related to foreign operations retrospectively. Instead, an entity may reset translation differences at the date of transition, determined in accordance with previous GAAP, to zero. The requirements of IAS 21 are then applied prospectively from the date of transition. The gain or loss on subsequent disposal of a foreign operation will only include foreign exchange differences that arose after the date of transition.

## 4.8 Investments in subsidiaries, jointly controlled entities and associates

Relevant IFRSs: IAS 27 *Consolidated and Separate Financial Statements*

IFRSs do not require entities to prepare separate financial statements. The requirement for entities to produce separate (sometimes referred to as 'parent-only') financial statements and the basis on which they should be prepared is generally a matter of legislation in the jurisdiction in which the entity is established.

If an entity prepares separate financial statements under IFRSs, IFRSs apply equally to both consolidated financial statements and the parent's separate financial statements. Therefore, in its separate financial statements, an entity should comply with all the IFRSs effective at the reporting date including IFRS 1.

IAS 27 deals with accounting for investments in subsidiaries, jointly controlled entities and associates in an entity's separate financial statements. These investments are required to be measured either:

a) at cost; or

b) in accordance with IAS 39.

A first-time adopter that measures an investment at cost under (a) above is permitted to measure the investment either at cost determined in accordance with IAS 27 or at 'deemed' cost. The deemed cost of an investment for this purpose is either its:

- fair value (determined in accordance with IAS 39) at the date of transition in the entity's separate financial statements; or
- previous GAAP carrying amount at the date of transition in the entity's separate financial statements.

The option to use deemed cost to measure investments in subsidiaries, jointly controlled entities and associates was added to IFRS 1 in 2008 and is effective for annual periods beginning on or after 1 July 2009, with earlier application permitted. The amendment addressed concerns that it may be difficult, or even impossible, and costly to determine cost in accordance with IAS 27. The alternative of accounting for such investments at fair value in accordance with IAS 39 will often be unattractive because of the cost of obtaining annual valuations on an ongoing basis.

First-time adopters are permitted to choose which measurement basis to use for each investment on an individual basis. Some may be measured at cost in accordance with IAS 27 and others at deemed cost. For those measured at deemed cost, the choice between fair value and previous GAAP carrying amount may also be made on an individual investment basis.

If an entity uses the deemed cost exemption for measurement of investments in subsidiaries, jointly controlled entities and associates, it must make certain specific disclosures in its first IFRS financial statements.

Use of the deemed cost exemption for the separate financial statements will result in a carrying amount for the investment that is different from the amount used in calculating goodwill for the consolidated financial statements. The latter amount is calculated in accordance with IAS 27 unless the exemption for business combinations is applied (which will often be the case for past acquisitions). Investments in jointly controlled entities and associates that are accounted for in accordance with IAS 39 in the consolidated financial statements are accounted for in the same way in the separate financial statements.

Although the exemption specifically references the separate financial statements, it effectively also provides relief from retrospective application for all entities that did not consolidate all of their investments prior to adopting IFRSs, whether they prepare separate financial statements or not. As a result of the exemption, a first-time adopter may now choose to retrospectively apply the requirements of IAS 27 to measure its cost of investment on first-time adoption or elect to recognise investment(s) not previously consolidated at either fair value or previous GAAP carrying amounts. The resultant value, either cost as defined under IAS 27 or deemed cost as permitted under IFRS 1, is used to calculate the entity's deemed cost of goodwill at the date of transition under IFRS 1.IG27 and IFRS 1.C4(j).

## 4.9 Assets and liabilities of subsidiaries, associates and joint ventures

Relevant IFRSs: IAS 27 *Consolidated and Separate Financial Statements*

This section deals with the requirements of IFRS 1 where a parent and a subsidiary become first-time adopters at different dates.
These requirements do not apply when the dates of adoption are the same. When the dates of adoption are the same, the parent and the subsidiary may apply the exemptions in IFRS 1 independently of each other; they are not required to take the same exemptions.

### *4.9.1 Subsidiary becomes a first-time adopter later than its parent*

If a subsidiary becomes a first-time adopter later than its parent, IFRS 1 permits a choice between two measurement bases in the subsidiary's financial statements. The subsidiary may measure its assets and liabilities at either:

- the carrying amount that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary; or

- the carrying amounts required by IFRS 1 based on the subsidiary's date of transition to IFRSs.

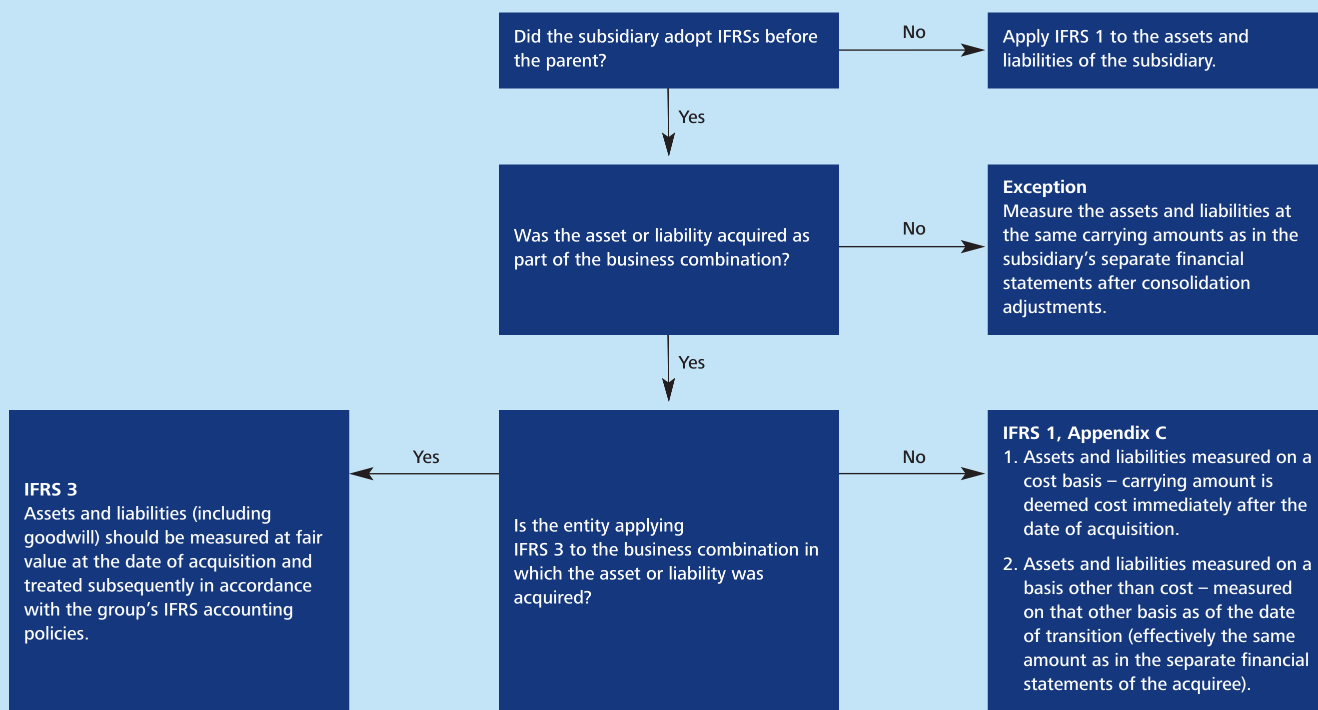
The carrying amounts under these alternatives could differ when the exemptions in IFRS 1 result in measurement that depends on the date of transition to IFRSs. They could also differ when the accounting policies used in the subsidiary's financial statements differ from those in the parent's consolidated financial statements.

If the assets/liabilities are measured based on the subsidiary's (later) date of transition to IFRSs, this does not change the carrying amount of the assets/liabilities in the consolidated financial statements.

The purpose of this exemption is to avoid the need to keep two parallel sets of records which the IASB accepted would be burdensome and not beneficial to users.

When the option is taken to use the parent's date of transition to IFRSs, the amounts recognised by the subsidiary are 'based on' the parent's date of transition. However, they may not be the same amounts because of the need to account for subsequent depreciation etc. up to the subsidiary's date of transition to IFRSs.

A similar election is available to an associate or jointly controlled entity that becomes a first-time adopter later than an entity that has significant influence or joint control over it.




### *4.9.2 Parent becomes a first-time adopter later than its subsidiary*

If a parent becomes a first-time adopter later than its subsidiary, the parent should, in its consolidated financial statements, measure the assets and liabilities of the subsidiary at the same carrying amount as in the financial statements of the subsidiary, after adjusting for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. The same approach applies in the case of associates and jointly controlled entities.

Although this appears in an Appendix of IFRS 1 dealing with exemptions, it is written as a requirement. The reason for this is unclear but the material was presumably included here to contrast with the situation where a subsidiary becomes a first-time adopter later than its parent. The Basis for Conclusions section of IFRS 1 devotes five paragraphs (BC59 to BC63) to explaining the reason for the exemption available to a subsidiary adopting IFRSs later than its parent. It then briefly adds "however, if a parent adopts IFRSs later than a subsidiary, the parent cannot, in its consolidated financial statements, elect to change IFRS measurements that the subsidiary has already used in its financial statements, except to adjust for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary". This is a statement of fact rather than an explanation of the reason for the requirement.

The requirement for consistency with the financial statements of the subsidiary is subject to adjusting for 'consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary'. These include, for example, accounting policy alignments and adjustments to eliminate profits on intra-group transactions. If the subsidiary was acquired in a business combination, the amounts may be determined after taking into account the IFRS 1 exemptions for business combinations. However, these exemptions apply only to assets and liabilities that existed at the date of the business combination. It may, therefore, be necessary to analyse the assets and liabilities of the acquired entity between those that existed at its date of acquisition and those that arose subsequently.

## 4.10 Financial instruments

Relevant IFRSs: IAS 32 *Financial Instruments: Presentation*
IAS 39 *Financial Instruments: Recognition and Measurement*

Accounting for financial instruments under IFRSs is complex and beyond the scope of this text. IFRS 1 sets out a number of optional exemptions to retrospective application of these rules.

The following text provides a high level summary of these exemptions. For further detail, we recommend that readers refer to Deloitte's comprehensive book on this subject *iGAAP 2009 Financial Instruments: IAS 32, IAS 39 and IFRS 7 explained*. Information as to how this book can be acquired is available at **www.iasplus.com**

At the time of writing, the IASB is in the process of finalising its new Standard on financial instruments, IFRS 9. This guide does not address the implications of the new Standard (which is expected to be effective from 2013) for first-time adopters. We encourage you to contact a Deloitte professional with any specific queries you have in this regard.

### *4.10.1 Compound financial instruments*

IAS 32 requires compound financial instruments to be separated at their inception into equity and liability components, based on the substance of the arrangement rather than their legal form. For example, IAS 32 requires convertible bonds (i.e. convertible by the holder into a fixed number of ordinary shares) and mandatorily redeemable non-cumulative preference shares with discretionary dividends to be separated into two individual equity and liability components. There are a number of considerations in IAS 32 that are taken into account in determining whether or not an instrument is a compound instrument which should be separated. The considerations focus on the extent to which the issuer has an obligation to deliver cash.

The general principle in IFRS 1 requires a first-time adopter to apply IAS 32 retrospectively and separate all compound financial instruments into a debt and equity portion. The classification of the components is based on the substance of the contractual arrangement at the date when the instrument first satisfied the criteria for recognition in IAS 32 without considering events subsequent to that date (other than changes to the terms of the instrument). The carrying amounts of the components are determined on the basis of circumstances existing when the instrument was issued and in accordance with the version of IAS 32 effective at the first IFRS reporting date.

If the liability component is no longer outstanding, retrospective application of IAS 32 results in two components of equity: one portion representing cumulative interest accrued on the liability component during its life using the effective interest method (which would normally reside in retained earnings); and the second portion representing the original equity component that would have been separated on initial recognition of the instrument. Retrospective application in this instance would not affect the size of equity, but rather the analysis between individual elements of equity. For this reason, IFRS 1 provides an exemption under which a compound financial instrument is not required to be separated into its components if the liability component is no longer outstanding on the date of transition to IFRSs.

### *4.10.2 Designation of previously recognised financial instruments*

An entity is permitted to designate any financial asset, other than an asset that meets the definition of 'held for trading', as an 'available-for-sale' financial asset at the date of transition to IFRSs.

A first-time adopter of IFRSs must de-designate financial assets and financial liabilities that under previous GAAP were designated as 'at fair value through profit or loss' if they do not qualify for such designation under IAS 39. An entity that presents its first IFRS financial statements for an annual period beginning on or after 1 September 2006 is permitted to designate, as at the date of transition to IFRSs, any financial asset or financial liability as at fair value through profit or loss provided that the asset or liability meets the criteria for such classification at that date. The criteria are detailed in IAS 39.9(b)(i), (9)(b)(ii) and (11A).

This designation is made at the date of transition as if the entity had never made a choice under a previous GAAP, and this is so even when that previous GAAP was identical to IAS 39.

The first-time adopter is required to disclose the fair value of the financial assets and financial liabilities designated into each category (available-for-sale, at fair value through profit or loss, etc.) at the date of designation and their classification and carrying amount in the previous financial statements.

### *4.10.3 Fair value measurement of financial assets or financial liabilities at initial recognition*

Because all financial assets and financial liabilities must be initially recognised at fair value, an entity must consider the specific guidance in IAS 39 on fair value when determining the carrying amount of financial assets and financial liabilities at the date of transition to IFRSs. This applies even if the financial asset or financial liability is not subsequently measured at fair value, because fair value at initial recognition will be the opening carrying amount at the date of transition to IFRSs.

IAS 39 has very specific guidance on determining fair value at initial recognition for financial assets and financial liabilities that are not traded in an active market. The Standard limits upfront gain/loss recognition unless the fair value of the instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. This is often referred to as 'day 1 P&L'. IFRS 1.D20 has specific transition requirements when applying the day 1 P&L guidance. IFRS 1 permits an entity to apply the day 1 P&L guidance in any one of the following ways:

- retrospectively;
- prospectively to transactions entered into after 25 October 2002; or
- prospectively to transactions entered into after 1 January 2004.

### *4.10.4 Other application issues relating to financial instruments*

#### 4.10.4.1 Measurement at fair value or amortised cost

The implementation guidance accompanying IFRS 1 addresses a number of additional implementation issues for the four categories of financial assets, as follows.

1. The designation of financial assets as 'held-to-maturity' investments is determined with reference to the entity's intent and ability at the date of transition. Sales of such investments prior to the date of transition do not trigger the 'tainting' rules in IAS 39, paragraph 9 which would otherwise require at least two full financial years to pass before an entity can again classify financial assets as 'held-to-maturity'. These investments are measured at amortised cost under IAS 39.

2. In considering the classification of financial assets as 'loans and receivables', reference is made to the circumstances that existed at origination or acquisition of the item, i.e. when the recognition criteria in IAS 39 were met. These assets are measured at amortised cost as determined under IAS 39.

3. Derivatives are always classified as 'at fair value through profit or loss' unless they are designated and effective hedging instruments. In either case, the derivatives will be measured at fair value at the date of transition. A non-derivative financial asset may only be classified as at fair value through profit or loss if it was:

    - acquired or incurred principally for selling or repurchasing in the near term;
    - at the date of transition, part of a portfolio of identified financial instruments that were managed together and for which there is evidence of a recent actual pattern of short term profit taking; or
    - designated as 'at fair value through profit or loss' at the date of transition if specified criteria are met.

4. The 'available-for-sale' category is the default category for all financial assets that do not fall into any of the other three categories above. Derivatives cannot be classified or designated as available-for-sale. Available-for-sale financial assets are measured at fair value; changes in fair value are recognised in other comprehensive income, except for impairment losses which are recognised in profit or loss. Additionally, foreign exchange gains and losses on monetary available-for-sale assets are recognised in profit or loss, but for non-monetary assets they are recognised in other comprehensive income. If the instrument is interest bearing, interest is calculated using the effective interest method and is always recognised in profit or loss.

Financial liabilities are generally measured at amortised cost, unless they are held for trading or designated as at fair value through profit or loss.

The carrying amount of a financial asset measured at cost or a financial liability measured at amortised cost in an entity's opening IFRS statement of financial position is determined based on the circumstances existing when that instrument first satisfied the recognition criteria in IAS 39. However, this requirement does not apply to financial assets and financial liabilities acquired in a past business combination which are being treated in accordance with the exemption in IFRS 1, Appendix C. If the financial asset acquired or financial liability assumed in a past business combination is measured at amortised cost under IAS 39, the carrying amount immediately after the business combination under previous GAAP is deemed cost under IFRSs at the date of acquisition. To determine the carrying amount under IFRSs at the date of transition, amortisation of this deemed cost is calculated using the effective interest method under IAS 39 since the date of acquisition, with this amortisation adjusting deemed cost.

Impairments of loans, receivables and available-for-sale financial assets are determined at the date of transition in accordance with estimates made under previous GAAP (after any adjustments to reflect differences in accounting policies) unless there is objective evidence that those estimates were in error. Revisions to those estimates subsequent to the date of transition are treated as impairment losses or reversals of impairment losses in the period in which the revisions are made.

**Example – change in impairment policy**

Under previous GAAP, Entity T measured impairment of financial assets carried at cost on an undiscounted basis. Entity T is a first-time adopter of IFRSs.

IAS 39 requires impairment losses to be measured using discounted cash flows. Therefore, at the date of transition to IFRSs, Entity T makes an adjustment to the carrying amount of those financial assets that are measured at amortised cost under IAS 39 to reflect the effect of discounting expected future cash flows.

In accordance with IFRS 1.11, 14 & IG58, Entity T should recognise this measurement adjustment as a consequence of the change in accounting policy in respect of the impairment of financial assets in the opening balance of retained earnings at the date of transition to IFRSs.

### 4.10.4.2 Bifurcation and separate measurement of certain embedded derivatives

Where a contract contains an embedded derivative that is not closely related to the host contract, IAS 39 requires the derivative to be recognised separately and measured at fair value. The initial carrying amounts of the host contract and embedded derivative are determined based on the circumstances at the date when the instrument first satisfies the IAS 39 recognition criteria. If an entity is unable to determine the fair value of the embedded derivative, it is determined as the difference between the fair value of the hybrid instrument and the fair value of the host contract. If the value of the embedded derivative cannot be determined using this technique, the entire instrument is treated as held for trading. In such circumstances, fair value is determined at the date of transition and the resulting adjustment is recognised in retained earnings.

**Example – embedded derivatives**

IAS 39 requires separate accounting for embedded derivatives not closely related to the host contract, where the entire contract is not one measured at fair value through profit or loss. On transition to IFRSs, does an entity assess whether an embedded derivative is closely related to the host contract or not, at the date of transition or at the date when that contract would have been initially recognised if IAS 39 had always been applied?

Full retrospective application of IAS 39 is required in this area. IFRIC 9 *Reassessment of Embedded Derivatives* clarifies that a first-time adopter should make its assessment of whether an embedded derivative is to be separated on the later of becoming party to the contract or when the contract is substantially modified. Assuming, in the above scenario, that there was no substantial modification to the arrangement, the assessment as to whether the embedded derivative is closely related is made at the date when the entity first became party to the contract and not on the date of transition to IFRSs. The initial carrying amounts of the embedded derivative and the host contract reflect circumstances at the date the whole instrument satisfied the recognition criteria of IAS 39. Once the carrying amount at initial recognition of an embedded derivative that is not closely related to the host contract is separately determined, it is then possible to determine the appropriate carrying amounts at the date of transition. These adjustments are recognised in the opening balance of retained earnings at the date of transition to IFRSs.

If the entity cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it treats the entire combined contract as a financial instrument held for trading measured at fair value through profit or loss.

### 4.10.4.3 Classification of financial instruments issued as liabilities, equity or derivatives

IFRS 1 requires an entity to recognise all financial instruments in accordance with IAS 32 and IAS 39. The classification of a financial instrument as an equity instrument or a financial liability is determined in accordance with IAS 32. In particular, compared to local GAAP in many countries and jurisdictions, IAS 32 requires that the classification as an equity instrument and a financial liability respectively be based on the substance of the contractual arrangement when the instrument first satisfied the recognition criteria in IAS 32, without considering events after that date other than changes to the terms of the instruments. For first-time adopters, this may result in reclassifications between equity and liability compared to previous GAAP, and a resulting impact on the financial position of the entity.

To be classified as an equity instrument, the first criteria is that the instrument must not include any contractual obligation to deliver cash or exchange of financial assets or financial liabilities on potentially unfavourable terms. Secondly, if the instrument will or may be settled in the issuer's own equity instruments, the following requirements must also be satisfied:

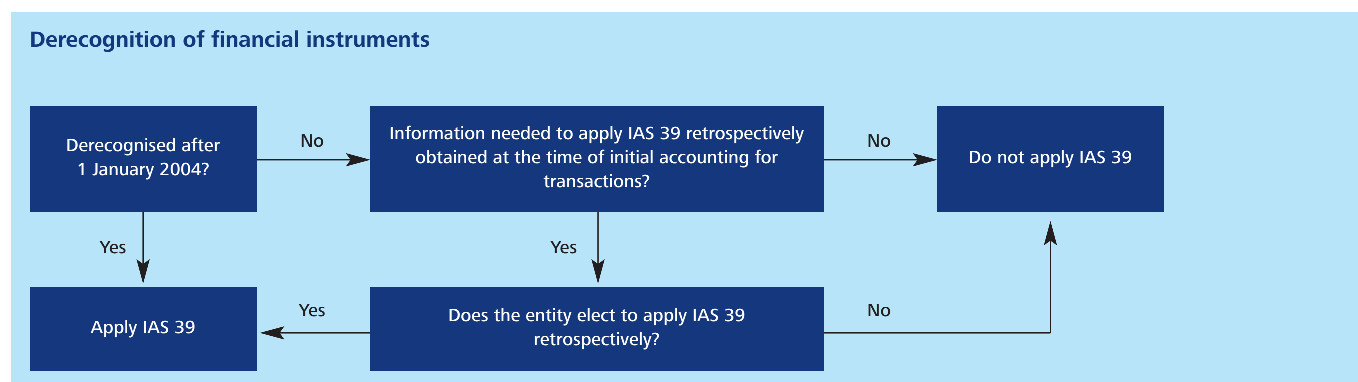
a) the instrument does not include a contractual obligation for the issuer to deliver a variable number of its own equity instruments (otherwise it is a financial liability); or

b) the instrument will be settled only by the issuer exchanging a fixed amount of cash for a fixed number of its own equity instruments (that is with gross physical settlement i.e. 'cash for shares', otherwise it is a financial liability).

4.10.4.4 Derecognition of financial assets and financial liabilities

Financial assets and financial liabilities are recognised and measured in the opening IFRS statement of financial position in accordance with the version of IAS 39 that is effective on the reporting date. As an exception to this general principle, non-derivative financial assets and non-derivative financial liabilities for which derecognition was achieved before 1 January 2004 under previous GAAP are not required to be recognised again in the opening IFRS statement of financial position (unless they qualify for recognition as a result of a subsequent event or transaction).

Notwithstanding the above, a first-time adopter may elect to apply the IAS 39 derecognition requirements retrospectively from any given date provided that the information required to do so was obtained at the time of initial accounting for those transactions.




**Example – derecognition of financial instruments at first-time adoption of IFRSs**

Company U transferred its trade receivables as part of a securitisation transaction before 1 January 2004. The receivables were derecognised in accordance with previous GAAP. Company U is adopting IFRSs for the first time in its financial statements for the year ending 31 December 20X2 (which is after 2004). The entity's date of transition is 1 January 20X1. Company U need not consider restating this securitisation transaction as it occurred prior to 1 January 2004.

However, if Company U enters into further transfers of financial assets as part of the same scheme after 1 January 2004 (e.g. to maintain a specified balance of credit card receivables), those transfers would have to satisfy the strict derecognition criteria of IAS 39 in order to qualify for derecognition.

In any case, all derivatives and other interests retained as part to the securitisation transaction must be recognised at the date of transition, even if they were incurred before 1 January 2004.

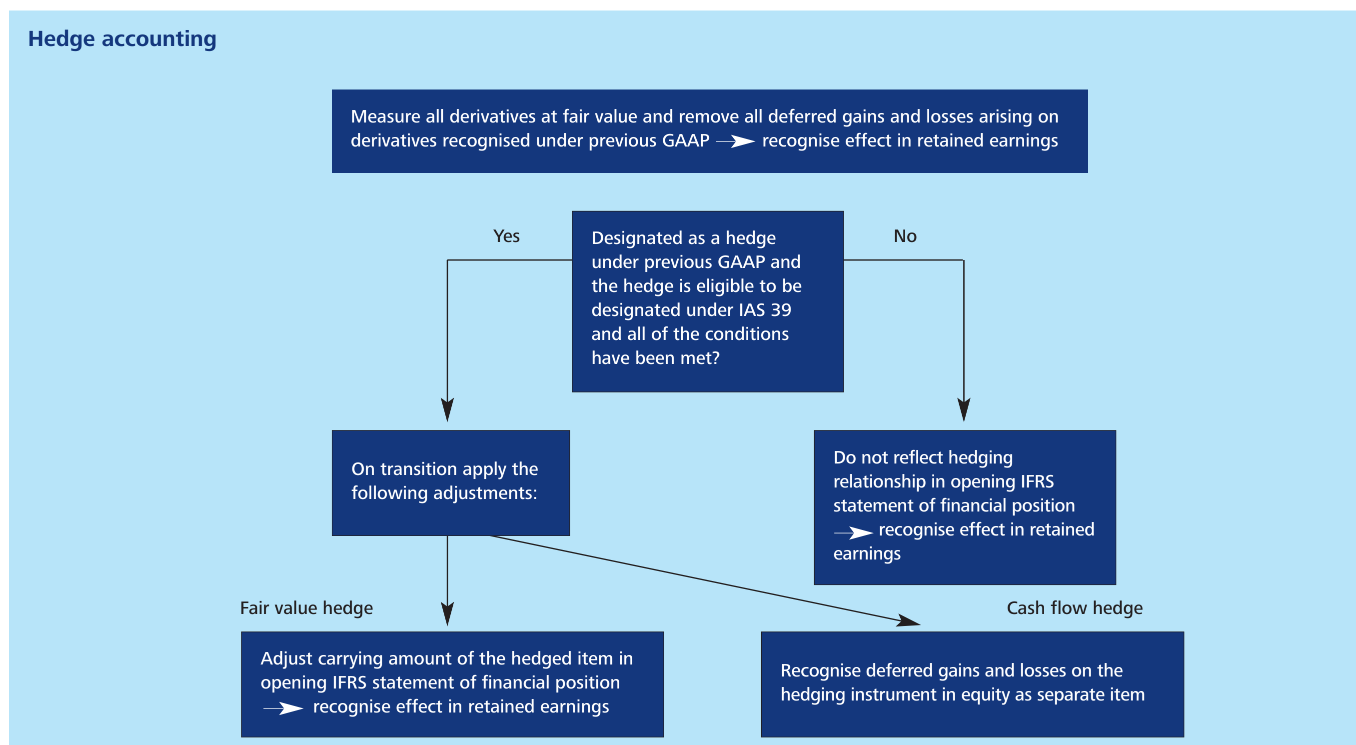
If the scheme involved a special-purpose entity (SPE), Company U would need to consolidate this entity retrospectively, if Company U controls the SPE as evaluated under IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*.

4.10.4.5 Hedge accounting

In contrast to the general principle of retrospective application in IFRS 1, a first-time adopter is not permitted to retrospectively designate transactions as hedges. The basis for this exception is that retrospective designation of a transaction as a hedge with the benefit of hindsight might be used by an entity in order to achieve a specific result. The exception therefore requires an entity to apply hedge accounting prospectively only.

Under the exception, a first-time adopter is required in its opening IFRS statement of financial position to recognise all derivatives at fair value and to eliminate against retained earnings all deferred gains and losses arising on derivatives that were reported under previous GAAP as assets and liabilities. The designation and documentation of the hedging relationship must be completed on or before the date of transition if it is to qualify under IAS 39 for hedge accounting. Designation and documentation of a hedge relationship under previous GAAP that is compliant with the hedging requirements of IAS 39 would be considered acceptable. If, before the date of transition to IFRSs, a transaction had been designated as a hedge but the hedge is not a relationship type that would qualify for hedge accounting under IAS 39, or it does not meet that Standard's conditions for hedge accounting (i.e. documentation, designation and assessment of effectiveness), the requirements of IAS 39.91 and IAS 39.101 should be applied to discontinue hedge accounting.

Accounting for hedges designated under previous GAAP on first-time adoption is dependent on the classification of the hedge as either a fair value hedge or a cash flow hedge.




Hedge accounting – fair value hedge designated under previous GAAP

In circumstances where a fair value hedging relationship was designated under previous GAAP and the gains and losses on that relationship were either not recognised or were deferred in the statement of financial position, IFRS 1 requires an adjustment to the hedged item.

Under IFRS 1, derivatives used as hedging instruments are recognised and measured at fair value at the date of transition. If the hedged item is not already measured at fair value and the gains and losses under previous GAAP were not recognised or deferred, the adjustment to the hedged item is measured at the lower of:

- that portion of the cumulative change in the fair value of the hedged item that reflects the designated hedged risk and was not recognised under previous GAAP; and
- that portion of the cumulative change in the fair value of the hedging instrument that reflects the designated hedged risk and was either not recognised or was deferred in the statement of financial position as an asset or liability under previous GAAP.

These requirements result in the hedged item being adjusted by the cumulative change in the fair value of the hedged item due to the designated risk where the fair value of the hedging instrument is more than the exposure on the hedged item. This entry is equivalent to the entry that would have been recognised had the entity always applied IFRSs.

If the derivative is less than exposure of the hedged item, the hedged item is adjusted to the value of the derivative which would have been different had the entity always applied IFRSs.

**Example – application of the guidance on fair value hedges at date of transition**

Company V acquired a foreign currency receivable. Company V reports in € and the receivable is denominated in £. Under previous GAAP, foreign currency receivables are measured at the spot rate on the date of the transaction and are not retranslated subsequently. The foreign currency receivable recognised is €1,000. At the same date, Company V entered into a derivative contract that it designated as a hedge against the foreign exchange risk inherent in the receivable. Derivatives were not recognised in the statement of financial position under previous GAAP. At the date of transition, the fair value of the derivative is €100 and the receivable retranslated at the spot rate at the date of transition is €920.

Under IFRS 1, Company V will recognise a derivative asset of €100 and adjust the carrying amount of the hedged item downwards by €80 (lower of the fair value movement of the derivative due to the designated hedged risk (€100) and the fair value movement of the hedged item related to the designated hedged risk (€80)). The resulting adjustment is recognised in retained earnings at the date of transition.

Hedge accounting – cash flow hedge designated under previous GAAP

Under previous GAAP, gains and losses on a cash flow hedge of a forecast transaction may have been deferred in the statement of financial position, or not recognised. If at the date of transition the forecast transaction is either still highly probable, or not highly probable but it is still expected to occur, the entire deferred gain or loss is recognised in equity. Any net cumulative gain or loss that is reclassified to equity on initial application of IAS 39 remains in equity until:

- the forecast transaction results in the recognition of a non-financial asset or non-financial liability and the amount deferred in equity, depending on the accounting policy choice of the entity, is either included in the initial carrying amount of the non-financial asset or non-financial liability (i.e. it is accounted for as a basis adjustment to the item) or remains in equity and is reclassified from equity into profit or loss when the item affects profit or loss;

- the forecast transaction affects profit or loss and the amount deferred in equity is reclassified into profit or loss (e.g. when a hedged highly probable forecasted sale actually occurs); or

- circumstances change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss immediately.

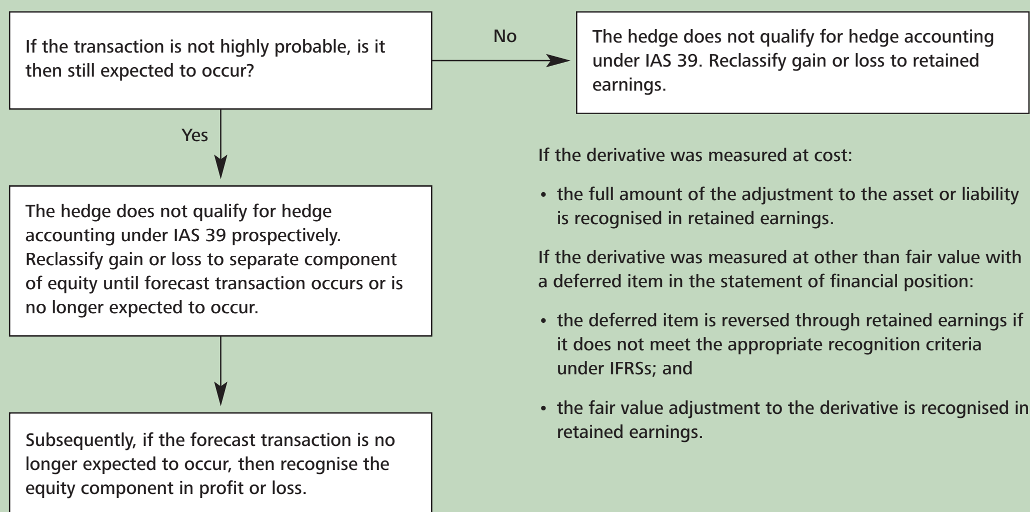
If the forecast transaction is not highly probable, but it is still expected to occur, the entity would not be able to hedge account prospectively. Therefore, subsequent gains and losses on the forward contract are recognised in profit or loss. However, the cumulative gain or loss on the forward contract deferred in equity (including that portion deferred on transition) up until the forecast transaction is no longer highly probable, remains in equity until either the transaction takes place or it is no longer expected to occur.

Further, if a hedge designated under previous GAAP is eligible to be designated under IAS 39 but does not satisfy the hedge criteria in IAS 39, the entity applies paragraphs 91 and 101 of IAS 39 dealing with discontinuing hedge accounting.

**Example – discontinuing hedge accounting**

Company W has a forecast transaction that does not, at the date of transition to IFRSs, meet the 'highly probable' criterion of IAS 39, paragraph 88(c).

The accounting treatment for the net cumulative gains or losses arising on measurement at fair value of the hedging instrument is dependent on whether the transaction is still expected to occur and can be illustrated as follows.



## 4.11 Decommissioning liabilities included in the cost of property, plant and equipment

Relevant IFRSs: IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*

Under IFRIC 1, specified changes in a decommissioning, restoration or similar liability are added to or deducted from the cost of the asset to which it relates, and the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life.

Retrospective application of the requirements of IFRIC 1 at the date of transition would require an entity to construct a historical record of all such adjustments that would have been made in the past. The IASB felt that in many cases this would not be practicable and provided an exemption for first-time adopters. Under the exemption, a first-time adopter may elect not to comply with requirements of IFRIC 1 for changes in such liabilities that occurred before the date of transition to IFRSs. Where this exemption is taken, the first-time adopter should:

- measure the liability as at the date of transition to IFRSs in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*;
- to the extent that the liability is within the scope of IFRIC 1, estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period; and
- calculate the accumulated depreciation on that amount, as at the date of transition to IFRSs, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity under IFRSs.

The exemption from full retrospective application means that first-time adopters will not need to estimate what provision would have been calculated at earlier reporting dates. Instead, the decommissioning liability is calculated at the date of transition and it is assumed that the same liability (adjusted only for the time value of money) existed when the asset was first acquired/constructed. When discounting the liability, it will, however, be necessary to take into account changes in the relevant discount rate in the period since the asset was first recognised.

If the 'fair value as deemed cost' exemption is used for the related asset, care is needed to ensure that the liability is not double counted. The valuation of the asset would be the gross amount before consideration of the costs of decommissioning. Any adjustment arising from recognition of the decommissioning liability is taken to retained earnings and is not added to the carrying amount of the asset.

The following example, reproduced from the Implementation Guidance issued with IFRS 1, highlights the impact of the exemption.

**IG Example 201 – changes in existing decommissioning, restoration and similar liabilities**

**Background**

An entity's first IFRS financial statements are for a period that ends on 31 December 20X5 and include comparative information for 20X4 only. Its date of transition to IFRSs is therefore 1 January 20X4.

The entity acquired an energy plant on 1 January 20X1, with a life of 40 years.

As at the date of transition to IFRSs, the entity estimates the decommissioning cost in 37 years' time to be 470, and estimates that the appropriate risk-adjusted discount rate for the liability is 5 per cent. It judges that the appropriate discount rate has not changed since 1 January 20X1.

**Application of requirements**

The decommissioning liability recognised at the transition date is CU77 (CU470 discounted for 37 years at 5 per cent).

Discounting this liability back for a further three years to 1 January 20X1 gives an estimated liability at acquisition, to be included in the cost of the asset, of CU67. Accumulated depreciation on the asset is CU67 x 3/40 = CU5.

The amounts recognised in the opening IFRS statement of financial position on the date of transition to IFRSs (1 January 20X4) are, in summary:

| | CU |
|---|---|
| Decommissioning cost included in cost of plant | 67 |
| Accumulated depreciation | (5) |
| Decommissioning liability | (77) |
| Net assets/retained earnings | (15) |

#### *4.11.1 Oil and gas assets*

If an entity elects to use the deemed cost exemption (see **section 4.4.5**) for oil and gas assets in the development or production phases, the entity must:

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

This treatment differs from the existing exemption in IFRS 1.D21 which requires entities to measure the liability as at the date of transition to IFRSs in accordance with IAS 37 and then estimate the amount that would have been included in the cost of the related asset when the liability first arose, and calculating accumulated depreciation on the amount, as of the date of transition.

## 4.12 Service concession arrangements

Relevant IFRS: IFRIC 12 *Service Concession Arrangements*

IFRIC 12 addresses the accounting by private sector operators involved in the provision of public sector infrastructure assets and services, such as schools and roads. The Interpretation does not address the accounting for the government (grantor) side of such arrangements. IFRIC 12 states that for arrangements falling within its scope, the infrastructure assets are not recognised as property, plant and equipment of the operator. Rather, depending on the terms of the arrangement, the operator will recognise:

- a financial asset (where the operator has an unconditional right to receive a specified amount of cash or other financial asset over the life of the arrangement); or
- an intangible asset (where the operator's future cash flows are not specified – e.g. where they will vary according to usage of the infrastructure asset); or
- both a financial asset and an intangible asset where the operator's return is provided partially by a financial asset and partially by an intangible asset.

An optional exemption relating to IFRIC 12 is available under IFRS 1. The exemption makes the transitional provisions included in the Interpretation available to first-time adopters of IFRSs. These transitional provisions generally require that the Interpretation should be applied retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, if it is not practicable for an operator (as defined in IFRIC 12) to apply the Interpretation retrospectively at the start of the earliest period presented, the operator should:

- recognise financial assets and intangible assets that existed at the start of the earliest period presented;
- use the previous carrying amounts of those financial and intangible assets (however previously classified) as their carrying amounts as at that date; and
- test financial and intangible assets recognised at that date for impairment, unless this is not practicable, in which case the amounts should be tested for impairment as at the start of the current period.

## 4.13 Borrowing costs

Relevant IFRSs: IAS 23 *Borrowing Costs*

IAS 23 prescribes the accounting treatment for borrowing costs. A revised version of the Standard issued by the IASB in March 2007 is effective for annual periods beginning on or after 1 January 2009, with earlier application permitted. IAS 23(2007) requires that borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. All other borrowing costs are expensed as incurred.

The IASB noted that it would be too onerous for first-time adopters who may have previously expensed all borrowing costs to be required to gather the necessary information for the retrospective capitalisation of borrowing costs. In addition, the IASB acknowledged that the requirements for application of mandatory capitalisation should be the same for entities that already apply IFRSs and for first-time adopters. Therefore, IFRS 1 was amended to add a new exemption from full retrospective application of IAS 23.

Where an entity first adopts IFRSs for a period beginning on or after 1 January 2009, or first adopts IFRSs for an earlier period but chooses to apply the revised version of IAS 23, IFRS 1 permits the entity to either:

- account for borrowing costs as though the requirements of IAS 23(2007) had always applied; or

- apply the transitional provisions of IAS 23. Where a first-time adopter chooses this option, references to the effective date are interpreted as 1 January 2009 or the date of transition to IFRSs, whichever is later.

When an entity begins capitalising borrowing costs on first adopting IFRSs, in accordance with the above requirements, the entity either:

- capitalises borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009 or the date of transition to IFRSs (whichever is later); or

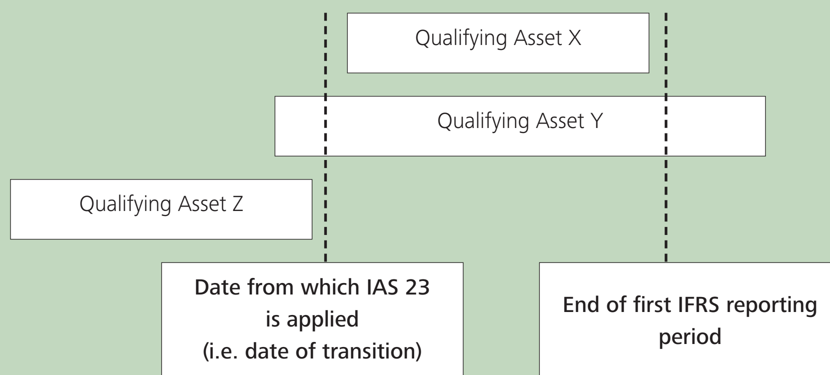
- designates another date before 1 January 2009 or the date of transition to IFRSs (whichever is the later) and capitalises borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that designated date.

However, if the entity establishes a deemed cost for an asset, the entity should not capitalise borrowing costs incurred before the date of the measurement that established the deemed cost.

**Example – commencement date prior to the effective date of IAS 23(2007)**

A first-time adopter capitalised borrowing costs under its previous GAAP using a method that was inconsistent with IAS 23(2007). The entity chooses to avail of the exemption in IFRS 1 which permits application of the transitional provisions of IAS 23(2007) on first-time adoption.

The entity has the following qualifying assets.




- The construction of Qualifying Asset X began after the date of transition and ended in the reporting period; accordingly, borrowing costs should be capitalised in accordance with IAS 23(2007). Any difference between the amount calculated under previous GAAP and the amount calculated under IAS 23 would be shown in the reconciliation of reported profit or loss for the comparative period in the entity's firstl IFRS financial statements.

- The construction of Qualifying Asset Y began before the date of transition and extends beyond the end of the first reporting period. Because the commencement date for capitalisation is before the date of transition, and the entity has elected to apply the transitional provisions of IAS 23, it is not required to restate the borrowing costs capitalised before the date of transition.

- The construction of Qualifying Asset Z began and ended before the date of transition. Because the entity has elected to apply the transitional provisions of IAS 23, it is not required to restate the borrowing costs capitalised before the date of transition.

## 4.14 Transfers of assets from customers

Relevant IFRS: IFRIC 18 *Transfers of Assets from Customers*

IFRIC 18 was issued in January 2009 to address divergent practice in the accounting by recipients for transfers of property, plant and equipment from customers. The Interpretation does not apply to government grants or service concession arrangements. IFRIC 18 concludes that when the item of property, plant and equipment transferred meets the definition of an asset from the perspective of the recipient, the recipient should recognise the asset at its fair value on the date of the transfer, with the credit recognised as revenue in accordance with IAS 18 *Revenue*.

In finalising IFRIC 18, the IFRIC noted that applying the change in accounting policy retrospectively would require entities to establish a carrying amount for assets that had been transferred in the past. That carrying amount would be based on historical fair values which may or may not be based on an observable price or observable inputs. Therefore, the IFRIC concluded that retrospective application could be impracticable and that the Interpretation should require prospective application to transfers received after its effective date.

To provide first-time adopters with the same relief, an exemption was also added to IFRS 1 under which first-time adopters may also apply the transitional provisions set out in paragraph 22 of IFRIC 18 *Transfers of Assets from Customers*. IFRS 1 notes that reference to the effective date within the transitional provisions of IFRIC 18 should be interpreted as 1 July 2009 or the date of transition to IFRSs, whichever is later. Earlier application is permitted provided that the valuations and other information needed to apply IFRIC 18 to past transfers were obtained at the time those transfers occurred. An entity must disclose the date from which IFRIC 18 is applied.

# 5. Other components of financial statements

This section addresses the accounting for a number of different financial statement components on first-time adoption. These areas are not necessarily specifically affected by IFRS 1's exceptions and exemptions, but implementation issues still frequently arise in practice.

- Intangible assets **(section 5.1)**
- Impairment of assets **(section 5.2)**
- Inventories **(section 5.3)**
- Construction contracts **(section 5.4)**
- Provisions **(section 5.5)**
- Income taxes **(section 5.6)**

## 5.1 Intangible assets

Relevant IFRSs: IAS 38 *Intangible Assets*

The opening IFRS statement of financial position should:

- exclude all intangible assets and other intangible items that do not meet the recognition criteria in IAS 38 at the date of transition to IFRSs; and
- include all intangible assets that meet the recognition criteria in IAS 38 at the date of transition to IFRSs except for intangible assets acquired in a business combination that were not recognised in the acquirer's consolidated statement of financial position under previous GAAP and also would not qualify for recognition under IAS 38 in the separate statement of financial position of the acquiree.

The criteria in IAS 38 require an entity to recognise an intangible asset if, and only if:

- it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and
- the cost of the asset can be measured reliably.

IAS 38 supplements these criteria with further, more specific, criteria for internally generated intangible assets. The costs of creating internally generated intangible assets are capitalised prospectively from the date when the recognition criteria are met. IAS 38 does not permit the use of hindsight to conclude retrospectively that the recognition criteria were met. Therefore, even if it is possible to conclude retrospectively that a future inflow of economic benefits is probable and the costs can be reconstructed reliably, IAS 38 does not permit the capitalisation of costs incurred before the date when the entity both:

- concludes, based on an assessment made and documented at the date of that conclusion, that it is probable that future economic benefits from the asset will flow to the entity; and
- has a reliable system for accumulating the costs of internally generated intangible assets when, or shortly after, they are incurred.

If an internally generated intangible asset qualifies for recognition at the date of transition to IFRSs, the asset should be recognised in the opening IFRS statement of financial position even if the related expenditure had been recognised as an expense under previous GAAP. If the asset does not qualify for recognition under IAS 38 until a later date, its cost is the sum of the expenditure incurred from that date.

The criteria described above for recognition of intangible assets under IAS 38 also apply to intangible assets acquired separately. Documentation prepared at the time to support the decision to acquire an asset will usually contain an assessment of the future economic benefits. Also, the cost of separately acquired intangible assets can usually be measured reliably.

If the amortisation methods and rates used for intangible assets under previous GAAP would be acceptable under IFRSs, the accumulated amortisation should not be restated in the opening IFRS statement of financial position. Any change in estimated useful life or amortisation pattern should be accounted for prospectively from the period when the change of estimate is made. In some cases, the amortisation methods and rates under previous GAAP might not be acceptable under IFRSs (e.g. because they were adopted solely for tax purposes). In such cases, where the effect is material, the accumulated amortisation in the opening IFRS statement of financial position should be adjusted retrospectively so that it complies with IFRSs.

**Example – indefinite-life intangible asset amortised under previous GAAP**

A first-time adopter has an intangible asset. Under previous GAAP, the intangible asset was being amortised over 20 years. Previous GAAP required that all intangible assets be amortised and did not have the concept of indefinite-life intangible assets. On adoption of IFRSs, the asset is deemed to have an indefinite useful life.

The entity should treat the change of classification to indefinite life as a change in accounting policy. As discussed in IFRS 1.IG51, the entity's amortisation method under previous GAAP is not acceptable under IFRSs. Therefore, the change from finite to indefinite life is a change in accounting policy that should be accounted for retrospectively in accordance with IFRS 1.

The transitional provisions in IAS 38, which state that a change in life from a finite to an indefinite useful life should be accounted for as a change in an accounting estimate do not apply to first-time adopters using IFRS 1. The entity must retrospectively restate the intangible asset as an indefinite-life asset, subject to mandatory annual impairment tests.

### *5.1.1 Optional exemption – deemed cost*

As discussed in **section 4.4**, the 'deemed cost' election may be applied to intangible assets. The election is only available for intangible assets to the extent that the recognition criteria in IAS 38 are satisfied and the fair value is determined by reference to an active market. If a first-time adopter applies this election to an intangible asset, it is not required to apply it to all other intangible assets in the same category. A first-time adopter may elect to measure an intangible asset at fair value at the date of transition regardless of whether the entity selects, as its accounting policy, to measure intangible assets under the cost model. Resulting adjustments are recognised in retained earnings unless the intangible asset was previously subsumed in goodwill.

**Example – election to use fair value or revalued amount**

Company X's accounting policy under previous GAAP was to revalue intangible assets every three years and to recognise the resulting adjustments in equity. Intangible assets were not amortised under previous GAAP. Company X acquired a sugar supply quota on 1 January 20X1 for CU500. The quota expires on 31 December 20X8. The quota was revalued on 31 December 20X3 to CU600. The revaluation was based on an active market and was broadly comparable to fair value. The sugar quota was not acquired as part of a business combination and Company X elects the cost model as its accounting policy for intangible assets under IFRSs. Company X has a date of transition of 1 January 20X6. The fair value of the quota at the date of transition determined with reference to an active market is CU750. Company X has an option (a) to measure the sugar quota at fair value at the date of transition, (b) to use the previous GAAP revaluation, or (c) to apply IAS 38 retrospectively.
The following journal entries are required in each instance.

| | CU | CU |
|---|---|---|
| *(a) Fair value at 1 January 20X6* | | |
| Dr. Intangible asset [CU750 – CU600] | 150 | |
| Cr. Retained earnings | | 150 |
| *Recognition of revaluation at date of transition* | | |
| *(b) Previous GAAP revaluation* | | |
| Dr. Retained earnings [CU600 x 2/5] | 240 | |
| Cr. Accumulated amortisation | | 240 |
| *Additional amortisation subsequent to the revaluation date* | | |
| *(c) Retrospective application of IAS 38* | | |
| Dr. Retained earnings [CU500 x 5/8] | 313 | |
| Cr. Accumulated amortisation | | 313 |
| *Amortisation subsequent to the date of acquisition* | | |
| Dr. Revaluation surplus [CU600 – CU500] | 100 | |
| Cr. Intangible asset | | 100 |
| *Reversal of revaluation under previous GAAP* | | |

Some items may have been recognised in the financial statements under previous GAAP at a fair value measurement at some time prior to the date of transition because of an event such as a privatisation or initial public offering. In these instances, the first-time adopter may elect to use the fair value determined on the date of the event as deemed cost at that date. Similar to revaluations, the first-time adopter determines the appropriate amortisation expense under IFRSs and adjusts accordingly.

### *5.1.2 Acquired in a business combination*

Considerations relating to intangible assets acquired in a business combination are also discussed in **section 4.1**.

#### 5.1.2.1 Intangible assets recognised under previous GAAP

Items carried at cost under previous GAAP, which satisfy the criteria for recognition in the relevant IFRSs, may be recognised at a deemed cost under IFRSs equal to the cost of the item under previous GAAP immediately subsequent to the date of acquisition. The first-time adopter determines the appropriate amortisation expense under IFRSs from acquisition date up until the date of transition. If that amount is materially different from the amount recognised under previous GAAP, that difference is recognised in retained earnings at the date of transition.

A first-time adopter has an option to (a) use the carrying amount immediately subsequent to the date of acquisition and determine the appropriate amortisation expense under IFRSs to the date of transition or (b) measure at fair value at the date of transition (provided that fair value is determined with reference to an active market). In both instances the resulting adjustment is recognised in retained earnings.

**Example – intangible asset acquired in a business combination and recognised under previous GAAP**

Parent Y acquired Subsidiary Z on 1 January 20X7. At that date, it recognised a fishing licence at fair value of CU350. The fishing licence had a remaining useful life of 7 years at the date of acquisition. Under previous GAAP, Parent Y measured intangible assets subsequently at cost and did not amortise them. The carrying amount on 1 January 20X9 is therefore CU350. Parent Y has selected as its accounting policy to subsequently measure intangible assets under the revaluation model in IAS 38. The fair value of the fishing licence on 1 January 20X9 determined with reference to an active market is CU430. Parent Y has a date of transition of 1 January 20X9. Parent Y has an option to measure the fishing licence at (a) fair value at the date of transition, or (b) the carrying amount immediately subsequent to the acquisition, less amortisation since that date. The following journal entries are required in each instance.

| | CU | CU |
|---|---|---|
| *(a) Fair value at 1 January 20X9* | | |
| Dr. Fishing licence asset [CU430 – CU350] | 80 | |
| Cr. Retained earnings | | 80 |
| *(b) Carrying amount immediately after the date of acquisition* | | |
| Dr. Retained earnings | 100 | |
| Cr. Accumulated amortisation [CU350 x 2/7] | | 100 |

#### 5.1.2.2 Intangible assets not recognised under previous GAAP

Intangible assets not recognised under previous GAAP do not have a cost of nil at the date of transition. IFRS 1 effectively requires retrospective application of IFRS 3 in these circumstances because these items are measured on the basis they would have been recognised in the separate financial statements of the subsidiary under IFRSs. The adjustment resulting from an intangible asset not recognised under previous GAAP that was consequently subsumed in goodwill is recognised against goodwill at the date of transition. This requirement does not prevent the entity from applying the fair value election in IFRS 1. Measurement after recognition of these intangible assets is dependent on whether the entity elects to measure the asset at cost or revalued amount under IAS 38.

**Example – intangible asset acquired in a business combination and not recognised under previous GAAP**

Parent A acquired Subsidiary B on 1 January 20X7. Subsidiary B had incurred development costs up to the date of acquisition amounting to CU350. The development costs satisfied the recognition criteria in IAS 38 at the date of acquisition; however, the asset was not recognised under previous GAAP. The development costs relate to a project with a useful life of 7 years starting from 1 January 20X7. No active market exists where such costs are traded. Parent A has selected as its accounting policy to measure intangible assets after recognition under the cost model. Parent A has a date of transition of 1 January 20X9. The following journal entries are required.

| | CU | CU |
|---|---|---|
| Dr. Development costs | 350 | |
| Cr. Accumulated amortisation [CU350 x 2/7] | | 100 |
| Cr. Goodwill [CU350 – CU100] | | 250 |

The fair value option is not available, as no active market exists. The related adjustment is recognised in goodwill because the asset was previously subsumed within goodwill.

## 5.2 Impairment of assets

Relevant IFRSs: IAS 36 *Impairment of Assets*

IAS 36 requires an impairment test to be conducted in some cases annually and in other cases when an indication exists that an asset may be impaired. For assets accounted for using the cost model, an impairment loss is recognised in profit or loss when an asset's recoverable amount is less than its carrying amount. Recoverable amount is the higher of an asset's fair value less cost to sell and its value in use.

### *5.2.1 Impairment testing at date of transition*

A first-time adopter is required to comply with IAS 36 at the date of transition. At this date, the first-time adopter:

- performs an impairment test on goodwill and intangible assets with indefinite useful lives regardless of whether an indication of impairment exists;
- determines whether there are any indications that other assets, groups of assets or cash-generating units are impaired at the date of transition;
- performs an impairment test on assets, groups of assets or cash-generating units for which indications of impairment have been identified;
- recognises any impairment losses in retained earnings; and
- reverses any impairment losses that no longer exist at that date except for previously recognised impairment losses on goodwill.

Impairment testing is performed on individual assets (e.g. intangible assets, property, plant and equipment, investment property measured under the cost model in IAS 40, finance lease assets and investments in associates and joint ventures) or, if the item does not generate cash flows that are largely independent from other assets, on the group of assets to which the individual asset belongs (its 'cash-generating unit').

### *5.2.2 Determination of cash-generating units*

A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. A first-time adopter may in practice find it difficult to identify its cash-generating units; however, in identifying a cash-generating unit, a first-time adopter considers at the date of transition those inflows of cash and cash equivalents that flow from parties outside the entity. To determine whether the cash flows are largely independent of other cash flows, the entity considers matters such as the method of managing cash flows in relation to an operation, and how the results of these operations are reported to management. If an active market exists for the output produced by an asset or group of assets, the asset or group of assets is identified as a cash-generating unit, irrespective of whether some or all of the output of the entity is used internally.

### *5.2.3 Goodwill*

Under IFRS 3, goodwill is not amortised, but is tested for impairment on an annual basis. Goodwill allocated to the identified cash-generating units is tested for impairment at the date of transition (and subsequently annually) regardless of whether or not there is an indication that it may be impaired. Under IAS 36, goodwill is allocated to identified cash-generating units that represent the lowest level at which goodwill is monitored by management and is not larger than an operating segment as determined in accordance with IFRS 8 *Operating Segments*. Measurement of impairment losses is based on the same estimates applied under previous GAAP unless there is objective evidence that those estimates were incorrect or not in accordance with IFRSs.

### *5.2.4 Intangible assets with indefinite useful lives*

Intangible assets designated at the date of transition to have indefinite useful lives are also tested for impairment under IAS 36 at the date of transition (and subsequently annually) by comparing carrying amounts with recoverable amounts.

### *5.2.5 Recognition of impairment losses at date of transition*

A first-time adopter recognises any impairment losses arising on transition to IFRSs as a result of changes in accounting policies in retained earnings at the date of transition. If a first-time adopter made a valid IFRS compliant estimate of an impairment loss under previous GAAP, it does not recognise any additional impairment losses nor reverse any previously recognised impairment losses. Subsequent impairment losses or reversals of impairment losses, including losses recognised prior to transition, are recognised in profit or loss in accordance with IAS 36.

The estimates used to determine whether an impairment loss is recognised and to measure any such impairment loss at the date of transition to IFRSs should be consistent with estimates made for the same date under previous GAAP, after making adjustments to reflect differences in accounting policies. This applies unless there is objective evidence that those estimates were in error. The impact of any later revisions to those estimates should be reported as an event of the period in which the revisions are made.

In assessing the need to recognise an impairment loss, and in measuring any such impairment loss at the date of transition to IFRSs, it may be necessary to make estimates that were not required under previous GAAP. Such estimates and assumptions should not reflect conditions that arose after the date of transition to IFRSs.

A first-time adopter is not permitted subsequent to the date of transition to reverse any impairment losses on goodwill.

### *5.2.6 Reversals of impairment losses*

IAS 36 requires the reversal of impairment losses in some cases. If the opening IFRS statement of financial position reflects impairment losses, any later reversal of those losses should be reflected in profit or loss except when IAS 36 requires them to be treated as a revaluation. This applies to both impairment losses recognised under previous GAAP and to additional impairment losses recognised on transition to IFRSs.

### *5.2.7 Disclosures*

The first IFRS financial statements should include the disclosures that IAS 36 would have required if the impairment losses or reversals had been recognised in the period beginning with the date of transition to IFRSs.

## 5.3 Inventories

Relevant IFRSs: IAS 2 *Inventories*

IAS 2 requires inventories to be measured at the lower of cost and net realisable value (estimated selling price in the ordinary course of business less estimated costs to complete and sell). The cost of inventories includes all costs necessary to bring the item to its present location and condition. IAS 2 requires an element of production overheads incurred in converting the materials to finished goods to be allocated to the cost of inventories. This is in contrast to some local GAAP frameworks which preclude entities from capitalising production overheads into the cost of inventories. IAS 2 precludes entities from revaluing items of inventories.

Under IAS 2, the cost of inventories that are not ordinarily interchangeable and goods or services produced and segregated for specific projects are assigned using specific identification of their individual costs.

The cost of inventories, other than for those referred to in the previous paragraph, is assigned by using the first-in, first-out (FIFO) or weighted average cost formula. The same cost formula is used for all inventories with a similar nature and use.

Write-downs of inventories to net realisable value are generally recognised in profit or loss unless the adjustment at the date of transition is as a result of a change in accounting policy or was made in error, in which case the adjustment is recognised in retained earnings at the date of transition.

There are no exceptions or exemptions in IFRS 1 regarding the accounting treatment of inventories and thus a first-time adopter must apply IAS 2 retrospectively in accordance with the general principle of IFRS 1. If a first-time adopter did not capitalise production overheads under previous GAAP, this requirement may be onerous because the first-time adopter is required to go back in the past and allocate production overheads to inventories.

## 5.4 Construction contracts

Relevant IFRSs: IAS 11 *Construction Contracts*
IFRIC 15 *Agreements for the Construction of Real Estate*

Under IAS 11, construction contracts are accounted for using the percentage of completion method when an entity is able to estimate reliably the outcome of a contract. Under the percentage of completion method, contract revenue and expenses are recognised as work progresses rather than when the work is complete. However, if an entity estimates that a contract will result in a loss, the total estimated loss related to a contract is recognised immediately. When an entity is unable to estimate reliably the outcome of a contract, it recognises contract revenue only to the extent of contract costs incurred which it believes will be reimbursed.

IAS 11 defines a construction contract as "a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use".

There are no exceptions or exemptions in IFRS 1 regarding construction contracts. Therefore, the general principle in IFRS 1 of full retrospective application of IFRSs effective at the reporting date applies to construction contracts.

Therefore, as at the date of transition, the first-time adopter analyses all construction contracts in progress and, if necessary, adjusts the recognition and measurement of such construction contracts to comply with IAS 11, with a corresponding adjustment to retained earnings.

The measurement of construction contracts involves the use of estimates to some extent (e.g. estimating total contract revenue, total contract costs or the percentage of completion). A first-time adopter's estimates under IFRSs should be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. Thus, the entity does not adjust construction contracts at the date of transition to reflect changes in the estimate of the stage of completion due to information received after the original estimate was made.

**Example – construction contract not recognised under previous GAAP**

Company C is a first-time adopter with a date of transition of 1 January 20X9. Under previous GAAP, Company C did not recognise construction contracts on the percentage of completion method. Company C entered into a fixed price contract on 1 January 20X8 to build a bridge for a price of CU9,000. The contractor's estimate of total contract costs is CU8,050 at 1 January 20X9. It will take 3 years to build the bridge. The costs incurred up to the date of transition are CU2,343 including CU250 relating to raw materials on site. Company C invoices the customer based on work certified which was CU3,000 in 20X8. Under previous GAAP, Company C recognised an expense of CU2,400 and revenue of CU3,000 in profit or loss.

The contractor determines the percentage of completion of the contract by calculating the proportion that contract costs incurred for work performed to the date of transition to IFRSs bear to the latest estimated total contract costs. The costs incurred to date on the contract exclude the CU250 related to raw materials because this expense has not yet been incurred on the project. The percentage of completion is therefore 26% [(CU2,343 – CU250)/CU8,050].

| The following journal entries are required at the date of transition. | CU | CU |
|---|---|---|
| Dr. Retained earnings | 660 | |
| Cr. Construction work in progress | | 660 |
| [CU3,000 – (CU9,000 x 26%)] | | |
| *Adjustment to revenue recognised under the contract* | | |
| Dr. Construction work in progress | 307 | |
| Cr. Retained earnings | | 307 |
| [CU2,400 – (CU8,050 x 26%)] | | |
| *Reversal of excess cost recognised in profit or loss* | | |

## 5.5 Provisions

Relevant IFRSs: IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*
IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
IFRIC 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment*

Under IAS 37, a provision should be recognised when and only when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

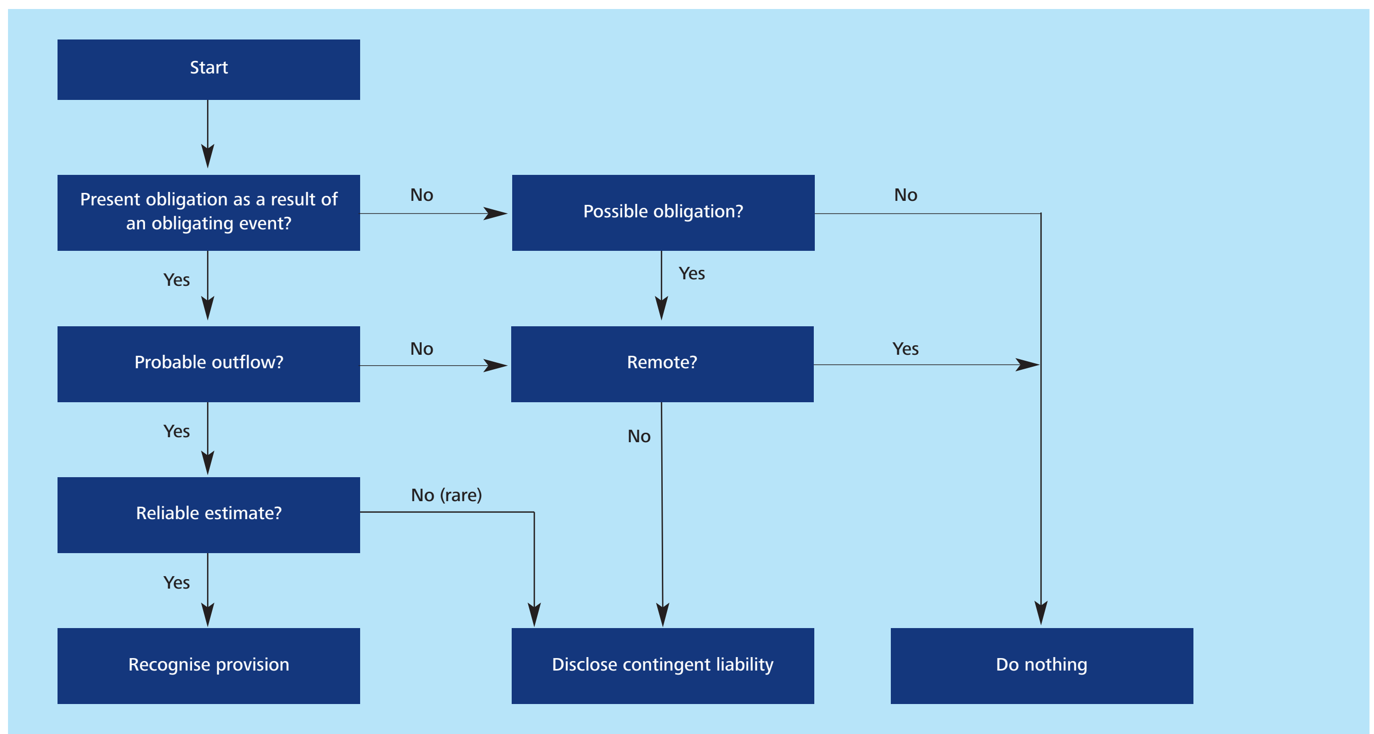
(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

No provision is recognised unless all of these conditions are met – neither in the opening IFRS statement of financial position nor subsequent to the date of transition.

Contingent liabilities and contingent assets are not recognised unless they are assumed in a business combination and meet certain conditions under IFRS 3, but they should be disclosed in the notes to the first IFRS financial statements.

The recognition criteria for provisions under IAS 37 can be illustrated with the following decision tree from Appendix B of IAS 37.




An obligating event that could cause a provision to be recognised subject to (b) and (c) above is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling the obligation. In this respect, a decision by management or the board of directors does not give rise to a constructive obligation at the end of a reporting period unless the decision has been communicated before that date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.

There are no exceptions or exemptions in IFRS 1 relating to provisions. Therefore, the general principle in IFRS 1 of retrospective application of the IFRSs effective at the reporting date applies to provisions, except that a first-time adopter may apply the transitional provisions of IFRIC 1 (see **section 4.11**).

Therefore, at the date of transition, the first-time adopter analyses any provisions recognised under previous GAAP and assesses whether they meet the recognition criteria under IAS 37. If provisions recognised under previous GAAP do not meet these criteria (e.g. because the entity does not have a present obligation), they are removed from the opening IFRS statement of financial position with a corresponding adjustment to retained earnings at the date of transition.

Likewise, if the first-time adopter has incurred liabilities that meet the recognition criteria for provisions, but for which no provision had been recognised under previous GAAP, a provision is recognised in the opening IFRS statement of financial position measured in accordance with IAS 37 at the date of transition, with a corresponding adjustment to retained earnings.

The best estimate of a provision recognised under previous GAAP made on a basis similar to that required under IAS 37 is not adjusted at the date of transition. However, if a provision was not recognised under previous GAAP that is required under IFRSs, the best estimate is determined based on circumstances existing at the date of transition.

### *5.5.1 Specific criteria for recognising restructuring provisions*

IAS 37 provides specific guidance on how the general recognition criteria for provisions apply to restructuring, which may be more restrictive than under previous GAAP.

Under IAS 37, a provision for restructuring cannot be recognised unless the entity has a detailed formal plan for restructuring, identifying specific information related to the restructuring and the entity has raised a valid expectation in those affected by the restructuring that it will carry out the restructuring by starting to implement the plan or announcing the main features of the plan to those affected.

Restructuring provisions recognised under previous GAAP that do not satisfy these recognition criteria are derecognised at the date of transition and the resulting adjustment is recognised in retained earnings.

### *5.5.2 Provisions assumed in a business combination*

#### 5.5.2.1 Where IFRS 3 is being applied retrospectively

Provisions assumed in a business combination to which IFRS 3 is applied retrospectively and that meet the criteria for recognition as at the date of acquisition are recognised as part of the accounting for the acquisition. The provision is measured at the best estimate at the date of acquisition of the present value of the expenditure required to settle the obligation at the date of acquisition based on appropriate current interest rates and facts and circumstances available at that date. Any changes compared to the amount recognised for provisions under previous GAAP are adjusted against goodwill.

Such provisions are measured again at the date of transition, and any change from the date of acquisition until the date of transition are recognised against retained earnings.

In addition, retrospective application of IFRSs could involve recognising contingent liabilities at the date of acquisition, with a corresponding adjustment to goodwill. Contingent liabilities do not meet the recognition criteria relating to provisions and as such would not have been recognised outside a business combination. However, any contingent liabilities recognised in the opening IFRS statement of financial position due to the first-time adopter applying IFRS 3 retrospectively to business combinations prior to the date of transition remains in the opening IFRS statement of financial position measured at the higher of:

(a) the amount that would be recognised in accordance with IAS 37; and

(b) the fair value at the date of the business combination less, when appropriate, cumulative amortisation in accordance with IAS 18 *Revenue*.

The contingent liability remains in the statement of financial position until it is settled, cancelled or expires. Where such a contingent liability expires, the provision is reversed in profit or loss.

#### 5.5.2.2 IFRS 1, Appendix C – provisions assumed in a business combination

Provisions assumed in business combinations to which the exemption in IFRS 1 is applied are recognised and measured at the date of transition under IAS 37 based on facts and circumstances available at that date. Changes to provisions (whether recognised or not) under previous GAAP are adjusted against retained earnings.

No adjustments are made to identifiable assets and liabilities recognised or goodwill calculated at the date of acquisition. Even if the goodwill was increased at the date of the acquisition due to the recognition of a provision that did not qualify for recognition under IFRSs, the removal of the provision from the opening IFRS statement of financial position at the date of transition is adjusted against retained earnings and not goodwill. However, goodwill is always tested for impairment and may, therefore, be written down anyway with a corresponding adjustment to retained earnings at the date of transition.

**Example – provision assumed in a business combination not recognised under previous GAAP**

Company D acquired Subsidiary E on 1 January 20X6. At that date, Subsidiary E had issued warranties with a best estimate of the resources required to settle the obligation at that date of acquisition of CU200. The liability was not recognised as a provision by Subsidiary E or as part of the business combination under previous GAAP in the consolidated financial statements of Company D. At the date of transition (1 January 20X9), the best estimate of resources required to settle the warranty liability at that date is CU125.

The treatment of the provision in the opening IFRS statement of financial position depends on whether Company D applies IFRS 3 or the exemption under IFRS 1, Appendix C to the acquisition of Subsidiary E. The following journal entries are required in each instance.

| *Application of IFRS 3 retrospectively* | CU | CU |
|---|---|---|
| Dr. Goodwill | 200 | |
| Cr. Provision (at the date of acquisition) | | 200 |
| Dr. Provision (re-measurement at the date of transition) | 75 | |
| Cr. Retained earnings | | 75 |
| *Application of IFRS 1, Appendix C exemption* | | |
| Dr. Retained earnings | 125 | |
| Cr. Provision (at the date of transition) | | 125 |

## 5.6 Income taxes

Relevant IFRSs: IAS 12 *Income Taxes*

Under IAS 12, unpaid taxes for the current and prior periods are recognised as a liability. If the amount paid in respect of current and prior periods exceeds the total amount of tax due, that excess is recognised as an asset. Income tax liabilities and income tax assets are measured at the amount expected to be paid or recovered using the tax rates applicable to that asset or liability.

Taxable temporary differences arise when the carrying amount of an asset exceeds its tax base or when the tax base of a liability exceeds its carrying amount. Deductible temporary differences arise when the tax base of an asset exceeds its carrying amount or when the carrying amount of a liability exceeds its tax base.

A deferred tax liability or deferred tax asset is recognised for all temporary differences except to the extent that they arise from:

(a) the initial recognition of goodwill; or

(b) goodwill for which amortisation is not deductible for tax purposes; or

(c) the initial recognition of an asset or liability in a transaction which:

 (i) is not a business combination; and

 (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

In addition, deferred tax assets are recognised in the statement of financial position only to the extent that it is probable that there will be sufficient taxable profits in the future to enable the asset to be recovered.

Deferred tax assets and deferred tax liabilities are measured at the tax rates expected to apply when the asset is settled or the liability is realised. The measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that would follow from the manner in which the entity expects, at the date of transition, to recover or settle the carrying amount of its assets and liabilities. Discounting of deferred tax assets and deferred tax liabilities is not permitted.

There are no exceptions or exemptions in IFRS 1 regarding the accounting for income taxes. An entity applies IAS 12 to temporary differences between the carrying amount of the assets and liabilities in its opening IFRS statement of financial position and their tax bases. Therefore, deferred tax is recognised in respect of adjustments to the carrying amounts of assets and liabilities recognised at the date of transition. However, if a first-time adopter recognised deferred tax under previous GAAP based on an accounting policy that is compliant with its IFRS accounting policy, it does not adjust its deferred tax estimate unless there is objective evidence that the estimate is in error.

Therefore, when calculating the deferred tax liability or asset to be included in its opening IFRS statement of financial position, a first-time adopter compares the carrying amounts of all assets and liabilities recognised in the opening IFRS statement of financial position (having made all the necessary adjustments and revaluations according to IFRS 1) with the tax base of those assets and liabilities. However, if a temporary difference would have arisen on the initial recognition of the asset or liability, the initial recognition exemption mentioned earlier may apply.

**Example – deferred tax when valuation used as deemed cost**

Entity F is adopting IFRSs for the first time. The entity has previously purchased land for CU100. Under its previous GAAP, the entity revalued the land to CU120, but did not recognise any deferred tax in respect of this revaluation. The entity decides to get a valuation of the land at transition date and uses this value, CU150, as the deemed cost in accordance with IFRS 1.D5. Part of the purchase price (CU10) is disallowable as a deduction by the local taxation authorities and, accordingly, the asset has a tax base at the date of purchase and the date of transition of CU90. The tax rate in the local jurisdiction is 30 per cent. The initial recognition exemption applies to the disallowable expenditure of CU10. There is no temporary difference between the remainder of the initial cost and the tax base (both CU90). On the date of transition, Entity G will recognise a deferred tax liability of CU15 [(CU150-CU100)*30%] being the deferred tax in respect of the difference between deemed cost and initial cost (CU50).

**Example – deferred tax on intangible asset recognised on transition**

On application of IFRS 1, Entity G recognised an intangible asset relating to development expenditure which was not acquired in a business combination. The expenditure had, under previous GAAP, been expensed for accounting purposes, but did not affect taxable profits at the time of the transaction (50 per cent was allowed for tax purposes over a period of five years). Had the intangible asset then recognised under IFRSs from the outset, a temporary difference would have arisen initially, and the transaction (restated to comply with IFRSs) would have affected neither taxable nor accounting profits at that date. In these circumstances, the exemption in IAS 12.15 applies, and Entity G is not required to recognise deferred tax in relation to this temporary difference.

Entity G may, however, be required to account for any temporary differences which have subsequently arisen (between initial transaction date and the date of transition to IFRSs) as a result of differences between accounting amortisation and the tax write-off period.

**Example – deferred tax asset not recognised under previous GAAP**

Company H is a first-time adopter in 20X4. Under previous GAAP, deferred taxes were recognised based on timing differences. In 20X1, by means of an internal group re-organisation that had no effect for financial reporting purposes, Company H generated an asset for tax purposes that will be deductible in the tax return over three years. This asset is not recognised for financial reporting purposes and does not meet any asset recognition criteria under IFRSs. Therefore, the asset will not be recognised on first-time adoption.

In its first IFRS consolidated financial statements, Company H should recognise a deferred tax asset at the date of transition to IFRSs for the net carrying amount of the tax asset that arose in 20X1. A temporary difference exists and a deferred tax asset should be recognised in the group's consolidated financial statements. The initial expense is an adjustment on first-time adoption of IFRSs and so will be recognised in retained earnings. Subsequent changes in the amount of the deferred tax asset will be recognised in profit or loss.

IAS 12 (paragraphs 9 and 17) provides examples of one type of temporary difference (i.e. 'timing differences'). However, IAS 12 is, overall, driven by a balance sheet approach, irrespective of whether an expense or income has previously been recognised in the statement of comprehensive income (or any separate income statement presented in accordance with IAS 1(2007).81(b)), such that the comparison should follow an analysis of the tax consequences on settlement (i.e. deferred tax is recognised on the difference between the tax base and the carrying amount for accounting purposes). If a tax base of an asset exists for tax purposes and no asset exists for accounting purposes, the carrying amount of that asset or liability should be deemed to be zero.

The calculation of the deferred tax liability or asset as at the date of transition as well as the assessment of whether it is probable that a tax asset will be recovered is based on the facts, circumstances and probabilities that existed when the financial statements under previous GAAP were prepared for the same date and should not take into account subsequent information available when the opening IFRS statement of financial position is actually prepared.

# 6. Questions and responses – implementation

**Question**

| | |
|---|---|
| Question 1 | The meaning of 'previous GAAP' |
| Question 2 | Choice of accounting policies on first-time adoption |
| Question 3 | Accounting policy and IFRS 1 exemption choices in interim periods in the first IFRS reporting period |
| Question 4 | Correction of an error that occurred prior to the date of transition to IFRSs |
| Question 5 | Step acquisition completed prior to the date of transition to IFRSs |
| Question 6 | Treatment of previous revaluation surplus on transition |
| Question 7 | Broadly comparable to fair value |
| Question 8 | Effect on employee benefit exemption when a parent and subsidiary have different dates of transition to IFRSs |
| Question 9 | Subsidiary applies IAS 19 prior to parent |
| Question 10 | Fair value hedge under previous GAAP that does not qualify as a fair value hedge under IFRSs |
| Question 11 | Hedge of a forecast transaction |
| Question 12 | Change in policy to measure impairment of financial assets carried at cost |
| Question 13 | Restatement of an asset as a result of prior requirements not in accordance with IFRSs |
| Question 14 | Capitalisation of costs incurred prior to the date of transition on internally generated intangible assets |

**Question 1 The meaning of 'previous GAAP'**

*Question*

If an entity previously prepared two complete sets of financial statements under different GAAPs (for example, a UK company prepared its statutory financial statements under UK GAAP and, in addition, prepared a complete set of US GAAP financial statements because it has a listing in the US), how should the term 'previous GAAP' be interpreted?

*Response*

Under IFRSs, management has a free choice in identifying its previous GAAP. However, such a free choice may be eliminated by the regulatory regimes within which it operates. In the example above, it is up to management to determine, in accordance with its regulatory environment, whether to transition from the statutory financial statements (under UK GAAP) or from the US GAAP financial statements previously presented.

An entity cannot have more than one set of IFRS financial statements. Therefore, it must have only one starting point for transition to IFRSs (albeit that it may choose to reconcile between this starting point and another previously used accounting framework).

It is important to keep in mind that the choice of previous GAAP must be a reasonable one (i.e. previous financial statements prepared for a specific purpose with limited circulation would not be an appropriate starting point when compared with the financial statements prepared for circulation to the entity's main user groups).

**Question 2 Choice of accounting policies on first-time adoption**

*Question*

In many cases, the accounting policy choices available under IFRSs differ from those available under a first-time adopter's previous GAAP. Where this is the case, or where a first-time adopter simply wishes to change its accounting policies on adoption of IFRSs, is the entity constrained by its previous accounting policies? For example, if an entity previously measured property, plant and equipment at cost, is it permitted to switch to the revaluation basis under IFRSs?

*Response*

Yes. An entity is not bound by accounting policy choices it made under previous GAAP when adopting IFRSs, even if the previous GAAP treatment is consistent with IFRSs. In particular, in those cases where IFRSs permit an explicit choice (e.g. whether to use cost or the revaluation basis for property, plant and equipment), that choice is not constrained by the policy adopted under previous GAAP. However, consideration should be given to regulatory views regarding policy changes upon first-time adoption when the policy under previous GAAP is acceptable under IFRSs.

**Question 3 Accounting policy and IFRS 1 exemption choices in interim periods in the first IFRS reporting period**

*Facts*

Entity O intends to adopt IFRSs on 1 January 20X2. Therefore, its first IFRS financial statements as defined in Appendix A of IFRS 1 will be for the year ended 31 December 20X2. In the jurisdiction in which Entity O operates, there is a requirement to present one year of comparative information for regulatory reporting. Accordingly, Entity O's date of transition to IFRSs, in accordance with Appendix A of IFRS 1, is 1 January 20X1.

Local regulations require Entity O to file both annual financial statements and quarterly financial reports with the securities exchange commission.

*Question*

Can Entity O change the accounting elections under IFRS 1 and/or the accounting policy choices reflected in its first interim financial report without having to consider the requirements of IAS 8?

*Response*

Yes. Entity O may change the IFRS 1 elections or accounting policies that it reflects in interim financial reports issued in the year of adoption without consideration of IAS 8 until a) the point that it issues its first IFRS financial statements or b) it issues financial statements that express compliance with IFRSs in all respects, whichever is sooner.

IFRS 1.27 notes that "IAS 8 does not deal with changes in accounting policies that occur when an entity first adopts IFRSs. Therefore, IAS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first IFRS financial statements." Therefore, once the first IFRS financial statements are issued, IAS 8 must be considered before changes are made.

It should be noted that an entity may change the choices it has made in its interim financial reports as long as those interim reports do not express full compliance with IFRSs; if they do, this makes them the equivalent of the first annual financial statements in accordance with IFRSs. Furthermore, the IASB has proposed in its exposure draft *Improvements to IFRSs* issued in August 2009 that if, during the period covered by its first IFRS financial statements, an entity changes its accounting policies or its use of IFRS 1's exemptions, it should explain the changes made and update its reconciliations.

**Question 4 Correction of an error that occurred prior to the date of transition to IFRSs**

*Question*

How should the correction of an error be accounted for if that error occurred prior to the date of transition to IFRSs?

*Response*

An entity may become aware of errors made under previous GAAP while undertaking the transition to IFRSs. If estimates or the application of accounting policies were in error prior to the date of transition, the correction of the error should be adjusted through retained earnings in the opening IFRS statement of financial position in the same manner as adjustments resulting from changes in accounting policies from previous GAAP to IFRSs. However, the reconciliations of equity and total comprehensive income presented in the first IFRS financial statements should clearly distinguish the correction of prior period errors from the adjustments resulting from transition.

**Question 5** **Step acquisition completed prior to the date of transition to IFRSs**

*Facts*

Company A acquired Subsidiary B in stages, beginning with a 10 per cent acquisition on 30 June 20X2, 30 per cent on 31 December 20X2, and 20 per cent on 31 December 20X3. Company A obtained control of Subsidiary B on 31 December 20X3. Company A is a first-time adopter with 1 January 20X7 as its date of transition to IFRSs. Company A has elected to restate all business combinations after 1 January 20X3.

*Question*

How does this election apply to the steps in the acquisition that occurred prior to 1 January 20X3?

*Response*

In this example, the date of acquisition of Subsidiary B is 31 December 20X3. Consequently, Company A should restate each step in the acquisition process, back to the first acquisition of 10 percent on 30 June 20X2. Because the election to restate past combinations is determined by reference to the date of acquisition of a subsidiary, the restatement of the first step would not affect the date from which all combinations are restated. Therefore, in the above example, restatement is not required for any other business combination prior to 1 January 20X3.

**Question 6** **Treatment of previous revaluation surplus on transition**

*Facts*

Under previous GAAP, Company D measured property, plant and equipment at a revalued amount that was broadly consistent with fair value. Company D has elected to use the revalued amount as deemed cost under IFRS 1.

*Question*

At the date of transition to IFRSs, how should Company D treat the revaluation amount recognised in equity under previous GAAP?

*Response*

IFRS 1 requires the adjustments arising from first-time adoption to be recognised in retained earnings or, if appropriate, another category of equity. If the revalued amount is to be recognised as a deemed cost on transition to IFRSs, the adjustment is recognised in retained earnings or in a separate category of equity, and is not included in the revaluation surplus. Therefore, a subsequent impairment loss cannot be recognised against the revaluation surplus, but instead should be recognised in profit or loss.

**Question 7** **Broadly comparable to fair value**

*Facts*

Under its prevous GAAP, Company E had an option to recognise property, plant and equipment at a revalued amount, measured as 80 per cent of its fair value.

*Question*

Is this amount broadly comparable to fair value for the purposes of IFRS 1?

*Response*

No. In order for the amount to be used as deemed cost, the measurement should represent a valid estimate of fair value. A percentage of fair value is not broadly comparable to fair value and, therefore, cannot be used as the asset’s deemed cost.

However, a revaluation in accordance with previous GAAP that is intended to be similar to a fair value adjustment, such as the application of a price index to a previous carrying amount, may be considered to be broadly comparable.

### Question 8 Effect on employee benefit exemption when a parent and subsidiary have different dates of transition to IFRSs

*Facts*

Subsidiary F is a publicly listed entity in Europe and a subsidiary of Company G. Subsidiary F adopted IFRSs in 20X5, using 1 January 20X4 as its date of transition. On first-time adoption, Subsidiary F elected to reset its defined benefit obligation 'corridor' to zero in accordance with IFRS 1.D10. Company G is adopting IFRSs in 20X8, using 1 January 20X7 as its date of transition.

*Question*

Can Company G elect to reset Subsidiary F's defined benefit obligation corridor to zero in 20X7 when Company G first adopts IFRSs?

*Response*

No. If a parent adopts IFRSs later than its subsidiary, it must use the subsidiary's date of transition as its own for that subsidiary in accordance with IFRS 1.D17. However, this does not override the requirement to prepare the consolidated financial statements using consistent accounting policies. For example, if Company G adopts a policy of immediate recognition of all actuarial gains and losses without the use of the corridor, the amounts reported by Subsidiary F (using the corridor) would be adjusted for the purposes of consolidation by Company G.

### Question 9 Subsidiary applies IAS 19 prior to parent

*Facts*

Company H acquired Subsidiary I on 1 January 20X2. Subsidiary I had adopted IFRSs prior to the date of acquisition and continues to apply IFRSs prospectively for local reporting purposes. Company I has a defined benefit plan accounted for under IAS 19 *Employee Benefits*. On 31 December 20X7, Company H adopts IFRSs (with a date of transition of 1 January 20X6).

*Question*

May Company H reset the benefit obligation corridor for all of its plans, except for those plans currently applying IAS 19?

*Response*

Yes. IFRS 1.D10 states that if a first-time adopter chooses to reset the benefit obligation corridor to zero, that election should apply to all of its plans. However, as Subsidiary I became a first-time adopter before Company H, IFRS 1.D17 requires Company H, in its consolidated financial statements, to measure the assets and liabilities of Subsidiary I at the same carrying amounts as in Subsidiary I's IFRS financial statements. As a result, Company H should account for Subsdiary I's plan at its current carrying amount because it is already accounted for under IAS 19, regardless of whether the corridor in the group's other plans is reset to zero.

### Question 10 Fair value hedge under previous GAAP that does not qualify as a fair value hedge under IFRSs

*Facts*

Under previous GAAP, Company J had a fair value hedge of a financial asset (such as a fixed rate debt security classified as held-to-maturity) that would be accounted for at amortised cost under IAS 39 *Financial Instruments: Recognition and Measurement*. The relationship does not meet the criteria for an effective hedge under IAS 39 and, therefore, no hedging relationship exists at the date of transition to IFRSs.

*Question*

How should the previous fair value adjustments to the carrying amount of the hedged item be accounted for on transition to IFRSs when IAS 39 is applied for the first time?

*Response*

No adjustment is required in the opening IFRS statement of financial position. Therefore, the opening balance of retained earnings is not adjusted for this item. However, in accordance with IAS 39, any previous adjustment to the carrying amount of the hedged item should be amortised to profit or loss over the remaining life of the debt instrument.

**Question 11 Hedge of a forecast transaction**

*Question*

If a forecast transaction does not, at the date of transition to IFRSs, meet the 'highly probable' criterion for cash flow hedges under IAS 39, how should any net cumulative gains or losses arising on measurement at fair value of the hedging instrument be accounted for at the date of transition?

*Response*

The appropriate accounting depends on whether or not the forecast transaction is still expected to occur, even though it is not 'highly probable'. The accounting will also be affected by how changes in the fair value of the hedging instrument were treated under previous GAAP.

*Cumulative gain or loss on hedging instrument reported directly in equity under previous GAAP.*

If, at the date of transition to IFRSs, the forecast transaction is not highly probable but is still expected to occur, the cumulative gain or loss on the hedging instrument that was reported directly in equity under previous GAAP is classified as a separate component of equity on the date of transition to IFRSs, and should remain as a separate component of equity until the forecast transaction occurs. Subsequently, in the event that the forecast transaction is no longer expected to occur, any related net cumulative gain or loss classified as a separate component of equity on the date of transition to IFRSs should be reported in profit or loss.

If, at the date of transition to IFRSs, the forecast transaction is not highly probable and is not expected to occur, the cumulative gain or loss on the hedging instrument that was reported directly in equity under previous GAAP should be reclassified to retained earnings at the date of transition.

*No cumulative gain or loss was reported directly in equity under previous GAAP*

If the derivative instrument was recognised at cost and, therefore, no change was recognised in the cumulative gain or loss account in equity, the full amount of the adjustment of the hedging instrument to fair value at the date of transition should be recognised in retained earnings.

If the derivative instrument was carried at an amount other than fair value with a deferred debit or credit in the statement of financial position recognised as an offset, that deferred debit or credit should be reversed through retained earnings if it does not meet the appropriate recognition criteria under IFRSs. The adjustment of the derivative instrument to fair value should also be recognised in the adjustment to retained earnings.

**Question 12 Change in policy to measure impairment of financial assets carried at cost**

*Facts*

Under previous GAAP, Company K measured impairment losses arising on financial assets carried at cost on an undiscounted basis. IAS 39 requires that impairment losses be measured on a discounted basis. Therefore, at the date of transition to IFRSs, Company K makes an adjustment to the carrying amount of those financial assets that are measured at amortised cost under IAS 39 to reflect the effect of discounting expected future cash flows.

*Question*

Should this adjustment be recognised as an adjustment to the opening balance of retained earnings at the date of transition?

*Response*

Yes. Company K should recognise this measurement adjustment as a change in accounting policy for impairments of financial assets directly in retained earnings at the date of transition.

**Question 13 Restatement of an asset as a result of prior requirements not in accordance with IFRSs**

*Facts*

Company L acquired Subsidiary M on 1 January 20X2. As part of the purchase price allocation, CU100 was allocated to purchased in-process research and development (IPR&D). In accordance with previous GAAP, this amount was expensed immediately in the consolidated financial statements. Company L is adopting IFRSs with a 1 January 20X4 date of transition.

*Question*

Should the amount allocated to IPR&D be recognised at the date of transition at an amount greater than zero?

*Response*

Yes. IFRS 1 requires the use of IFRS compliant accounting policies in the opening IFRS statement of financial position and throughout the periods presented. If an entity has chosen a policy of amortisation that does not comply with IFRSs, the intangible asset should be restated as if an IFRS compliant amortisation method had always been used. The immediate write-off of IPR&D is not in accordance with IFRSs and, therefore, should be reversed and amortisation recognised appropriately.

Because this write-off of IPR&D occurred outside of the business combination, the exemption in Appendix C of IFRS 1 for a business combination does not apply.

**Question 14 Capitalisation of costs incurred prior to the date of transition on internally generated intangible assets**

*Facts*

Company N is adopting IFRSs with a date of transition of 1 January 20X4. At Company N's date of transition, certain internal development projects were determined to be in the development phase in accordance with IAS 38 *Intangible Assets*.

*Question*

Is Company N required to recognise an asset for the development costs that would have been recognised under IAS 38 had Company N reported under IFRSs prior to the date of transition?

*Response*

If Company N can reliably measure the development costs incurred, then recognition of the asset is required. However, IFRS 1 recognises that in many cases where prior cost data was not reliably segregated (e.g. between research and development), measurement of the development costs may not be reliable. In these circumstances, an asset should not be recognised. If measurement can be determined reliably from the date the recognition criteria were met, then the restatement should be made as if IAS 38 had always applied. Therefore, only costs incurred during the development phase should be capitalised in the opening IFRS statement of financial position.

# 7. Practical considerations

There are some important decisions to be made prior to conversion to IFRSs which will affect the amount of work required on adoption and the financial results and the financial position reported both on conversion and in the post-conversion period. Although there are no right or wrong answers to the multitude of questions that need to addressed on first-time adoption, it is important for first-time adopters to spend the time necessary to understand which combination of answers will yield the best result for their entity. Key choices to be made include:

- **selection of accounting policies:** under IFRSs, it will be necessary to make accounting policy choices, and the choices made can have a significant impact on an entity's financial results and the processes that support financial reporting. For example, is it more appropriate to recognise property, plant and equipment at cost or at fair value? If fair value is considered to be the better choice, how will the entity go about obtaining appropriate fair value information?

- **IFRS elections at date of transition:** IFRS 1 contains many elective exemptions that represent unique choices for first-time adopters. Entities must evaluate which exemptions are relevant and which options offered within the exemptions lead to the best outcome for the entity. For example, if the exemption to restate borrowing costs prospectively is taken, there is clearly less effort involved because accounting records do not need to be restated retrospectively. However, retrospective application of IAS 23 B*orrowing Costs* could actually yield a better result, perhaps for an entity that has recently completed the construction of a material asset and expensed all related borrowing costs because it was not permitted to capitalise borrowing costs under previous GAAP.

There is no 'one size fits all' answer to these questions; time and careful consideration are required to achieve the optimal end result.

In some jurisdictions, the biggest hurdle for first-time adopters of IFRSs can be to understand the Standards themselves. If previous GAAP requirements are not closely aligned to IFRSs, the learning curve may be steep.

We recommend that first-time adopters approach their conversion projects as follows:

- determine how closely aligned IFRSs are to the previous GAAP requirements in your jurisdiction;

- build up IFRS knowledge by reading the Standards, attending conferences, taking courses etc. We recommend that you obtain a copy of Deloitte's *iGAAP 2010 A guide to IFRS reporting*, one of the most comprehensive reference manuals available (see **www.iasplus.com** for details). The extent of the effort required will clearly vary depending on the level of convergence between your previous GAAP and IFRSs;

- focus on the key areas of difference between IFRSs and previous GAAP requirements which are of most importance to your own financial statements;

- take time to understand and apply IFRS 1; and

- consider and plan for the collateral effects of conversion on the organisation as a whole.

### Getting things done

Experience has shown us that IFRS conversion is not an easy task and the most common mistake made by first-time adopters is starting the process too late. With sufficient time, however, an IFRS conversion can be managed and approached in the same manner as any other large-scale project.

The journey towards IFRSs can be broken down into the following implementation steps.

1. **Scoping** Identify a project leader. Determine timelines and identify information needs.

2. **Enabling** Identify project teams and a steering committee. Ensure that the IFRS conversion project has sufficient resources, assistance from professional advisors and executive-level support.

3. **Executing** Determine IFRS accounting policies and IFRS 1 election choices. Prepare opening statement of financial position and address other financial reporting and operational matters arising from IFRS adoption.

4. **Monitoring** Keep ahead of ongoing changes to IFRSs. Remain current on ongoing financial statement and knowledge requirements.

### Assessing the collateral effects

Perhaps one of the biggest challenges hidden in an IFRS conversion project is the management of the collateral effects of the changeover. Seeing the adoption of IFRSs as a 'back-office' project that only affects the 'figures' can be a very big mistake. The experience of those who have been through the conversion process indicates that conversion to IFRSs affects much more than just the financial results of an entity. Conversion to IFRSs will also affect other corporate functions that prepare, utilise or are otherwise linked to an entity's financial information in some way. These may include:

- information technology;
- treasury and finance;
- tax;
- legal;
- investor relations;
- human resources;
- audit committee and/or internal and external auditors.

### How can Deloitte assist?

Deloitte has assisted hundreds of clients with their IFRS conversion activities by providing competent, capable and timely advice and assistance on conversion. We bring years of experience and the combined brainpower of a global network of thousands of professionals who have 'been there, done that' and now stand ready to assist and advise you on your IFRS conversion project.

Such advice and assistance can include the following.

- **Scoping** Outlining the scope of the task and identifying the critical areas that need to be addressed with higher priority.
- **Enabling** Helping to develop internal expertise through on-site or group training.
- **Executing** Assisting with key accounting choices, researching implications of alternatives, providing examples of alternative accounting treatments, as well as providing assistance with managing the collateral effects of conversion on areas such as IT systems, legal, HR etc.
- **Monitoring** Assessing the appropriateness of the selection of accounting principles as well as proving advice on implementing and maintaining controls over the conversion process.

Contact your Deloitte representative to experience first-hand how we can help make your conversion journey a smooth and comfortable one.

# Appendix A Illustrative reconciliations

The following pages illustrate one way of presenting the reconciliations to previous GAAP required in an entity's first IFRS financial statements. In this example:

- the entity's date of transition to IFRSs is 1 January 20X1, with its first IFRS financial statements prepared to 31 December 20X2;
- the changes in accounting policies as a consequence of the transition to IFRSs are as described in the notes following the reconciliations; and
- the applicable tax rate is 30%.

## A.1 Effect of IFRS adoption for the statement of financial position

| CU million | Notes | As at 01/01/20X1 (date of transition) | | | As at 31/12/20X1 (end of last period presented under previous GAAP) | | |
|---|---|---|---|---|---|---|---|
| | | Previous GAAP | Effect of transition to IFRSs | Opening IFRS statement of financial position | Previous GAAP | Effect of transition to IFRSs | IFRSs |
| Property, plant and equipment | | 75,973 | – | 75,973 | 96,680 | – | 96,680 |
| Goodwill | f | 1,567 | – | 1,567 | 5,504 | 730 | 6,234 |
| Intangible assets | a | 200 | 2,056 | 2,256 | 943 | 2,458 | 3,401 |
| Financial assets | j | 2,680 | 36 | 2,716 | 4,065 | 16 | 4,081 |
| **Total non-current assets** | | **80,420** | **2,092** | **82,512** | **107,192** | **3,204** | **110,396** |
| Trade and other receivables | | 12,943 | – | 12,943 | 14,630 | – | 14,630 |
| Inventories | e | 6,868 | 1,286 | 8,154 | 12,270 | 1,571 | 13,841 |
| Other receivables | | 4,711 | – | 4,711 | 4,953 | – | 4,953 |
| Long-term bonds held for sale | | 7,158 | – | 7,158 | 3,902 | – | 3,902 |
| Cash and cash equivalents | | 13,959 | – | 13,959 | 19,567 | – | 19,567 |
| **Total current assets** | | **45,639** | **1,286** | **46,925** | **55,322** | **1,571** | **56,893** |
| **Total assets** | | **126,059** | **3,378** | **129,437** | **162,514** | **4,775** | **167,289** |
| Interest-bearing loans | b | 36,111 | (1,405) | 34,706 | 59,887 | (1,272) | 58,615 |
| Trade and other payables | c | 9,574 | 309 | 9,883 | 10,045 | 238 | 10,283 |
| Restructuring provision | g | 1,000 | (1,000) | – | 2,180 | (2,180) | – |
| Dividends to shareholders | d | 1,568 | (1,568) | – | 1,824 | (1,824) | – |
| Current tax liability | | 1,053 | – | 1,053 | 962 | – | 962 |
| Deferred tax liability | h | 2,384 | 1,736 | 4,120 | 4,855 | 2,249 | 7,104 |
| **Total liabilities** | | **51,690** | **(1,928)** | **49,762** | **79,753** | **(2,789)** | **76,964** |
| **Total assets less total liabilities** | | **74,369** | **5,306** | **79,675** | **82,761** | **7,564** | **90,325** |
| Issued capital | | 22,800 | – | 22,800 | 22,800 | – | 22,800 |
| Share premium | | 16,559 | – | 16,559 | 16,559 | – | 16,559 |
| Revaluation reserve | | 1,313 | – | 1,313 | 1,899 | – | 1,899 |
| Available-for-sale securities reserve | j | – | 25 | 25 | – | 11 | 11 |
| Hedging reserve | c | – | (309) | (309) | – | (238) | (238) |
| Retained earnings | a,b,d,e,f,g | 33,697 | 5,590 | 39,287 | 41,503 | 7,791 | 49,294 |
| **Total equity** | | **74,369** | **5,306** | **79,675** | **82,761** | **7,564** | **90,325** |

## A.2 Reconciliation of equity

| CU million | | As at 01/01/20X1 (date of transition) | As at 31/12/20X1 (end of last period presented under previous GAAP) |
|---|---|---|---|
| **Total equity under previous GAAP** | | **74,369** | **82,761** |
| Recognition of development costs less amortisation | a | 2,056 | 2,458 |
| Loans measured at amortised cost instead of nominal value | b | 1,405 | 1,272 |
| Derivatives recognised and measured at fair value | c | (309) | (238) |
| Dividend not recognised as liability until declared | d | 1,568 | 1,824 |
| Production overheads in cost of inventories | e | 1,286 | 1,571 |
| Goodwill no longer amortised as from the date of transition | f | – | 730 |
| Derecognition of restructuring provision | g | 1,000 | 2,180 |
| Recognition of available-for-sale securities | j | 36 | 16 |
| | | 7,042 | 9,813 |
| Tax effect of the above | h | (1,736) | (2,249) |
| **Total adjustment to equity** | | **5,306** | **7,564** |
| **Total equity under IFRSs** | | **79,675** | **90,325** |

## A.3 Effect of IFRS adoption for the consolidated statement of comprehensive income for the year ended 31 December 20X1

| CU million | Notes | Year ended 31/12/20X1 (the latest period presented under previous GAAP) Previous GAAP | Effect of transition to IFRSs | IFRSs |
|---|---|---|---|---|
| Revenue | | 123,531 | – | 123,531 |
| Cost of sales | a,e | (75,982) | 688 | (75,294) |
| **Gross profit** | | **47,549** | **688** | **48,237** |
| Other income | | 1,476 | – | 1,476 |
| Distribution costs | f | (19,406) | 730 | (18,676) |
| Administrative expenses | g | (11,178) | 1,180 | (9,998) |
| Other expenses | | (477) | | (477) |
| **Operating profit** | | **17,964** | **2,598** | **20,562** |
| Share of profit in associates before tax | | 943 | – | 943 |
| Finance costs (net) | b | (2,870) | (133) | (3,003) |
| **Profit before tax** | | **16,037** | **2,465** | **18,502** |
| Income taxes | | (5,481) | (520) | (6,001) |
| **Profit for the year** | | **10,556** | **1,945** | **12,501** |
| **Other comprehensive income** | | | | |
| Recognition of available-for-sale securities | j | – | 11 | 11 |
| Derivatives recognised and measured at fair value | c | – | (238) | (238) |
| **Total other comprehensive income** | | **–** | **(227)** | **(227)** |
| **Total comprehensive income** | | **10,556** | **1,718** | **12,274** |

## A.4 Reconciliation of profit

| CU million | Notes | Year ended 31/12/20X1 (the latest period presented under previous GAAP) Profit before tax | Profit for the year |
|---|---|---|---|
| **Previous GAAP** | | **16,037** | **10,556** |
| Recognition of development costs less amortisation | a | 403 | 282 |
| Loans measured at amortised cost instead of nominal value | b | (133) | (93) |
| Production overheads in cost of inventories | e | 285 | 200 |
| Goodwill no longer amortised as from the date of transition | f | 730 | 730 |
| Restructuring provision not recognised as a liability | g | 1,180 | 826 |
| **Total adjustment to profit or loss** | | **2,465** | **1,945** |
| Profit or loss under IFRSs | | **18,502** | **12,501** |
| Other comprehensive income | | | (227) |
| **Total comprehensive income under IFRSs** | | | **12,274** |

Note: No statement of comprehensive income was produced under previous GAAP. Therefore the reconciliation at A.4 starts with profit under previous GAAP.

## A.5 Effect of IFRS adoption for the consolidated statement of cash flows

| CU million | Notes | 20X1 (the latest period presented under previous GAAP) Previous GAAP | Effect of transition to IFRSs | IFRSs |
|---|---|---|---|---|
| Net cash flows from operating activities | k | 22,578 | (4) | 22,574 |
| Net cash flows from investing activities | i,k | (33,888) | 2,759 | (31,129) |
| | | **(11,310)** | **2,755** | **(8,555)** |
| Net cash flows from financing activities | | 14,163 | – | 14,163 |
| **Net increase (decrease) in cash and cash equivalents** | | **2,853** | **2,755** | **5,608** |
| **Cash and cash equivalents at beginning of period** | | **20,400** | **(6,441)** | **13,959** |
| **Cash and cash equivalents at end of period** | | **23,253** | **(3,686)** | **19,567** |

## A.6 Analysis of cash and cash equivalents under IFRSs

| | | 01/01/X1 | 31/12/X1 |
|---|---|---|---|
| **Cash and cash equivalents consist of:** | | | |
| Long-term bonds with a maturity of less than three months | i | 717 | 216 |
| Cash and bank balances | i | 13,242 | 19,351 |
| **Total cash and cash equivalents** | | **13,959** | **19,567** |
| **Long-term bonds consist of:** | | | |
| Long-term bonds with a maturity of less than three months | | 717 | 216 |
| Long-term bonds with a maturity above three months | i | 6,441 | 3,686 |
| | | 7,158 | 3,902 |

## A.7 Notes to the reconciliations

The transition to IFRSs has resulted in the following changes in accounting policies:

a) When the criteria in IAS 38 *Intangible Assets* are met, development costs are recognised as an intangible asset measured at cost less accumulated amortisation. Amortisation commences when the asset is available for use. Under previous GAAP, development costs were recognised as an expense when incurred. The effect of the change is an increase in equity as at 31 December 20X1 of CU2,458 million (CU2,056 million as at 1 January 20X1) and an increase in profit before tax for 20X1 of CU403 million (CU282 million after tax).

b) Financial liabilities, other than derivatives, are measured at amortised cost. Under previous GAAP, financial liabilities were measured at their nominal value and any difference between the amount initially recognised and the maturity amount of the liability was recognised in profit and loss. The effect of the change is an increase in equity as at 31 December 20X1 of CU890 million (CU983 million as at 1 January 20X1) and a decrease in profit before tax for 20X1 of CU133 million (CU93 million after tax).

c) Derivative financial instruments are initially recognised at fair value and subsequently measured at fair value. Changes in the fair value of derivative financial instruments classified as hedging instruments and meeting the criteria for hedging future cash flows are recognised in other comprehensive income, and reclassified to profit or loss in the period in which the hedged forecast transaction affects profit or loss. Under previous GAAP, derivatives hedging future cash flows were not recognised. The effect of the change is a decrease in equity as at 31 December 20X1 of CU238 million (CU309 million as at 1 January 20X1). The change does not affect profit or loss for 20X1.

d) Dividends to shareholders declared after the end of the reporting period but before the financial statements are authorised for issue are not recognised as a liability at the end of the reporting period, but are disclosed separately in the notes. Under previous GAAP, dividends for the accounting year were recognised as a liability. The effect of the change is an increase in equity at 31 December 20X1 of CU1,824 million (CU1,568 million as at 1 January 20X1). The change does not affect profit or loss for 20X1.

e) Inventories are measured at the lower of cost and net realisable value. Cost include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Under previous GAAP, production overheads were not included in the cost of inventories. The effect of the change is an increase in equity at 31 December 20X1 of CU1,100 million (CU900 million as at 1 January 20X1) and an increase in profit before tax for 20X1 of CU285 million (CU200 million after tax).

f) Under IFRSs, goodwill is not amortised but is measured at cost less impairment losses. Under previous GAAP, goodwill was amortised on a straight-line basis through profit or loss based on an individual assessment of the economic life of the asset, subject to a maximum of 20 years. The effect of the change is an increase in equity as at 31 December 20X1 of CU730 million and an increase in profit before tax for 20X1 of CU730 million. The change does not affect the equity at 1 January 20X1. The change has no tax effect as deferred taxes are not recognised for temporary differences arising from goodwill for which amortisation is not deductible for tax purposes.

g) Under previous GAAP, a restructuring provision relating to head office activities was recognised. Under IFRSs, this provision does not qualify for recognition as a liability, neither at 1 January 20X1 nor at 31 December 20X1. The effect of the change is an increase in equity at 31 December 20X1 of CU1,526 million (CU700 million as at 1 January 20X1) and an increase of profit before tax for 20X1 of CU1,180 million (CU826 million after tax).

| | 1 January 20X1 | 31 December 20X1 |
|---|---|---|
| h) The above changes increased the deferred tax liability as follows: | | |
| Recognition of development cost asset (a) | 617 | 737 |
| Recognition of financial liabilities (b) | 422 | 382 |
| Production overheads included in cost of inventories (e) | 386 | 471 |
| Restructuring provision derecognised (g) | 300 | 654 |
| Recognition of available-for-sale securities (j) | 11 | 5 |
| Total | 1,736 | 2,249 |

i) Under previous GAAP, long-term bonds with a maturity exceeding three months were included in cash and cash equivalents in the cash flow statement. Under IFRSs, investments in and sales of such bonds are included in cash flows from investing activities.

j) Under previous GAAP, available-for-sale (AFS) equity securities were measured at cost. Under IFRSs, these AFS instruments are recognised at fair value with unrealised gains or losses recorded in other comprehensive income. Upon transition to IFRSs, after recognition of deferred tax, the effect of the change is an increase in equity at 31 December 20X1 of CU16 million (CU36 million as at 1 January 20X1). The change does not affect profit or loss for 20X1.

k) Under previous GAAP, cash flows from interest and dividends received were classified as cash flows from operating activities. IFRSs permit a choice as to how such cash flows are classified, provided that the classification is consistently applied from period to period. Management has decided that cash flows from interest and dividends received should be classified as investing cash flows because they are recognised to be returns on the investments held during the reporting period. The effect of the change is a reclassification of CU4 million from 'net cashflows from operating activities' into 'net cashflows from investing activities'.

# Appendix B Presentation and disclosure checklist

IFRS 1 includes a number of presentation and disclosure requirements which supplement the disclosures required by other Standards in an entity's first IFRS financial statements. These additional disclosure requirements are set out in the checklist below.

Note that IFRS 1 does not provide any exemptions from the presentation and disclosure requirements in other Standards. Therefore, all of the presentation and disclosure requirements of other Standards must be complied with in an entity's first IFRS financial statements, except that the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for disclosures regarding changes in accounting policies do not apply.

| Reference | Presentation/disclosure requirement |
|---|---|
| | **Opening IFRS statement of financial position** |
| IFRS 1.6 | An entity shall prepare and present an opening IFRS statement of financial position at the date of transition to IFRSs. |
| | **Employee benefits** |
| IFRS 1.D11 | An entity may disclose the amounts required by paragraph 120A(p) of IAS 19 *Employee Benefits* as the amounts are determined for each accounting period prospectively from the date of transition to IFRSs. |
| | *Note: Paragraph 120A(p) of IAS 19 requires disclosure of a five-year history of defined benefit obligations and plan assets, and of experience adjustments. The exemption in IFRS 1.D11 (see above) allows first-time adopters to disclose these amounts only from the transition date to IFRSs.* |
| | **Share-based payment transactions** |
| IFRS 1.D2 | For all grants of equity instruments to which IFRS 2 has not been applied (e.g. equity instruments granted on or before 7 November 2002 – see below), the first-time adopter shall nevertheless disclose the information required by paragraphs 44 and 45 of IFRS 2. |
| IFRS 1.D2 | *Note: First-time adopters are encouraged, but not required, to apply IFRS 2 to equity instruments that were granted on or before 7 November 2002. First-time adopters are also encouraged, but not required, to apply IFRS 2 to equity instruments that were granted after 7 November 2002 that vested before the later of (a) the date of transition to IFRSs and (b) 1 January 2005. However, if a first-time adopter elects to apply IFRS 2 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments determined at the measurement date, as defined in IFRS 2.* |
| IFRS 1.D3 | For liabilities to which IFRS 2 is applied, a first-time adopter is not required to restate comparative information to the extent that the information relates to a period or date that is earlier than 7 November 2002. |
| IFRS 1.D3 | *Note: A first-time adopter is encouraged, but not required, to apply IFRS 2 to liabilities arising from share-based payment transactions that were settled before the date of transition to IFRSs. A first-time adopter is also encouraged, but not required, to apply IFRS 2 to liabilities that were settled before 1 January 2005.* |
| | **Insurance contracts** |
| IFRS 1.D4 | *Note: A first-time adopter may apply the transitional provisions of IFRS 4 (paragraphs 42 to 44 of IFRS 4* Insurance Contracts*).* |
| IFRS 4.44 | In applying paragraph 39(c)(iii) of IFRS 4, a first-time adopter need not disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies IFRS 4. |
| IFRS 4.44 | In applying paragraph 39(c)(iii) of IFRS 4, if it is impracticable for the first-time adopter to prepare information about claims development that occurred before the beginning of the earliest period for which the entity presents full comparative information that complies with IFRS 4, the entity shall disclose that fact. |

| Reference | Presentation/disclosure requirement |
|---|---|
| | **Comparative information** |
| IFRS 1.21 | The entity's first IFRS financial statements shall include at least three statements of financial position, two statements of comprehensive income, two separate income statements (if presented), two statements of cash flows and two statements of changes in equity and related notes, including comparative information. |
| | *Non-IFRS comparative information and historical summaries* |
| | Where the entity presents either (i) historical summaries of selected data that do not comply with the recognition or measurement requirements of IFRSs for periods before the first period for which it presents full comparative information under IFRSs, or (ii) comparative information under previous GAAP in addition to the comparative information required by IAS 1 *Presentation of Financial Statements*, the entity shall: |
| IFRS 1.22(a) | a) label the previous GAAP information prominently as not being prepared under IFRSs; and |
| IFRS 1.22(b) | b) disclose the nature of the main adjustments that would make the previous GAAP information comply with IFRSs. |
| | *Notes:* |
| IFRS 1.22 | *1. Where the entity presents historical summaries of selected data for periods before the first period for which it presents full comparative information under IFRSs, IFRS 1 does not require such summaries to comply with the recognition and measurement requirements of IFRSs.* |
| IFRS 1.22(b) | *2. When disclosing the nature of the adjustments that would make the information comply with IFRSs, the entity need not quantify those adjustments.* |
| | **Explanation of transition to IFRSs** |
| | *Reconciliations* |
| IFRS 1.23 | The entity shall explain how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cash flows. |
| | *Note: Paragraphs 24 to 33 of IFRS 1, set out below, specify the detailed disclosures required to comply with IFRS 1.23. Example 11 included in the* Implementation Guidance *accompanying IFRS 1 illustrates one way of satisfying the requirements of paragraphs 24(a) and 24(b), 25 and 26. See also Appendix A to this guide.* |
| IFRS 1.24(a) | The entity's first IFRS financial statements shall include reconciliations of its equity reported under previous GAAP to its equity under IFRSs for both of the following dates: |
| | a) the date of transition to IFRSs; and |
| | b) the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP. |
| IFRS 1.24(b) | The entity's first IFRS financial statements shall include a reconciliation to its total comprehensive income under IFRSs for the latest period in the entity's most recent annual financial statements. The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for the same period or, if an entity did not report such a total, profit or loss under previous GAAP. |
| IFRS 1.25 | *Note: The reconciliations required by paragraphs 24(a) and 24(b) of IFRS 1 (as outlined above) are required to give sufficient detail to enable users to understand the material adjustments to the statement of financial position and statement of comprehensive income.* |
| IFRS 1.24(c) | If the entity recognised or reversed any impairment losses for the first time in preparing its opening IFRS statement of financial position, its first IFRS financial statements shall include the disclosures that IAS 36 *Impairment of Assets* would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to IFRSs. |
| IFRS 1.25 | If the entity presented a statement of cash flows under its previous GAAP, it shall explain the material adjustments to the statement of cash flows. |
| IFRS 1.26 | If the entity has become aware of errors made under previous GAAP, the reconciliations required by paragraphs 24(a) and 24(b) of IFRS 1 (as outlined above) shall distinguish the correction of those errors from changes in accounting policies. |

| Reference | Presentation/disclosure requirement |
|---|---|
| IFRS 1.27 | *Note: IAS 8 does not deal with changes in accounting policies when an entity first adopts IFRSs. Therefore, IAS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first IFRS financial statements.* |
| IFRS 1.28 | If the entity did not present financial statements for previous periods, its first IFRS financial statements shall disclose that fact. |
| | ***Designation of financial assets or financial liabilities*** |
| IFRS 1.29 | If the entity has designated any previously recognised financial assets or financial liabilities as 'at fair value through profit or loss' or as 'available-for-sale' (as permitted by paragraph D19 of IFRS 1), the following shall be disclosed: |
| | a) the fair value of any financial assets or financial liabilities designated into each category at the date of designation; and |
| | b) the classification and carrying amount in the previous financial statements. |
| | ***Use of fair value as deemed cost*** |
| | If the entity has used fair value in its opening IFRS statement of financial position as deemed cost for an item of property, plant and equipment, an investment property or an intangible asset (as permitted by paragraphs D5 and D7 of IFRS 1), the entity's first IFRS financial statements shall disclose, for each line item in the opening statement of financial position: |
| IFRS 1.30(a) | a) the aggregate of those fair values; and |
| IFRS 1.30(b) | b) the aggregate adjustment to the carrying amounts reported under previous GAAP. |
| | ***Use of deemed cost for investments in subsidiaries, jointly controlled entities and associates*** |
| | If an entity uses a deemed cost in its opening IFRS statement of financial position for an investment in a subsidiary, jointly controlled entity or associate in its separate financial statements (see paragraph D15 of IFRS 1), the entity's first IFRS separate financial statements shall disclose: |
| IFRS 1.31(a) | a) the aggregate deemed cost of those investments for which deemed cost is their previous GAAP carrying amount; |
| IFRS 1.31(b) | b) the aggregate deemed cost of those investments for which deemed cost is fair value; and |
| IFRS 1.31(c) | c) the aggregate adjustment to the carrying amounts reported under previous GAAP. |
| | ***Use of deemed cost for oil and gas assets*** |
| IFRS 1.31A | If an entity uses the exemption for oil and gas assets (see paragraph D8A(b) of IFRS 1), it shall disclose that fact and the basis on which carrying amounts determined under previous GAAP were allocated. |
| | ***Interim financial reports*** |
| IFRS 1.32 | *Note: The requirements below refer to interim reports prepared under IAS 34* Interim Financial Reporting *for interim periods covered by the entity's first IFRS financial statements. They supplement the requirements of IAS 34.* |
| IFRS 1.32(a) | Where an entity presents an interim financial report under IAS 34 for part of the period covered by its first IFRS financial statements, and it presented an interim financial report for the comparable interim period of the immediately preceding financial year, each such interim financial report shall include reconciliations of: |
| | i) its equity under previous GAAP at the end of that comparable interim period to its equity under IFRSs at that date; and |
| | ii) its total comprehensive income under IFRSs for that comparable interim period (current and year-to-date). The starting point for that reconciliation shall be total comprehensive income under previous GAAP for that period or, if an entity did not report such a total, profit or loss under previous GAAP. |
| IFRS 1.32(b) | In addition to the reconciliations required by paragraph 32(a) of IFRS 1 (as outlined in the previous point), the entity's first interim financial report under IAS 34 for part of the period covered by its first IFRS financial statements shall include the reconciliations described in paragraphs 24(a) and 24(b) of IFRS 1 (supplemented by the details required by paragraphs 25 and 26 of IFRS 1) (see section headed 'reconciliations' above) or a cross-reference to another published document that includes those reconciliations. |
| IFRS 1.33 | If a first-time adopter did not, in its most recent annual financial statements under previous GAAP, disclose information material to an understanding of the current interim period, its interim financial report shall disclose that information or include a cross-reference to another published document that includes it. |

| Reference | Presentation/disclosure requirement |
|---|---|
| IFRS 1.33 | *Note:* *IAS 34 requires minimum disclosures, which are based on the assumption that users of the interim financial report also have access to the most recent annual financial statements. However, IAS 34 also requires an entity to disclose 'any events or transactions that are material to an understanding of the current interim period'.* |
| | ***Adoption of amendments in advance of effective dates*** |
| IFRS 1.38 | If an entity applies the revised exemptions for measurement of the cost of investments in subsidiaries, jointly controlled entities and associates introduced in May 2008 for an annual period beginning before 1 July 2009, it shall disclose that fact. |
| IFRS 1.38 | *Note:* Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (Amendments to IFRS 1) *issued in May 2008 introduced additional exemptions relating to the measurement of the cost of such investments on first-time adoption. Those amendments are effective for annual periods beginning on or after 1 July 2009. Earlier application is permitted.* |
| IFRS 1.39A | If an entity applies the additional exemptions on first-time adoption introduced in July 2009 for an annual period beginning before 1 January 2010, it shall disclose that fact. |
| IFRS 1.39A | *Note:* Additional Exemptions for First-time Adopters (Amendments to IFRS 1) *issued in July 2009 introduced additional exemptions relating to oil and gas assets and arrangements containing leases. Those amendments are effective for annual periods beginning on or after 1 January 2010. Earlier application is permitted.* |

# Deloitte IFRS resources

In addition to this publication, Deloitte Touche Tohmatsu has a range of tools and publications to assist in implementing and reporting under IFRSs. These include:

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| **www.iasplus.com** | Updated daily, iasplus.com is your one-stop shop for information related to IFRSs. |
| Deloitte's IFRS e-Learning modules | e-Learning IFRS training materials, available without charge at **www.iasplus.com** |
| IAS Plus Update newsletter | Newsletters issued at the time of release of new and revised Standards and Interpretations, exposure drafts and discussion documents, including summaries of the documents and consideration of principal amendments. To subscribe, visit **www.iasplus.com** |
| iGAAP 2010: A guide to IFRS reporting | 4th edition (November 2009). A comprehensive guide to the requirements of IFRSs. |
| IFRSs in your pocket | Published in several languages, this pocket-sized guide includes summaries of all IASB Standards and Interpretations, updates on agenda projects, and other IASB-related information. |
| IFRSs and US GAAP: A pocket comparison | A summary of the principal differences in pocket-sized format, including a status report as to what is being done about each difference. |
| Presentation and disclosure checklist | Checklist incorporating all of the presentation and disclosure requirements of IFRSs. |
| Model financial statements | Model financial statements illustrating the presentation and disclosure requirements of IFRSs. |
| iGAAP 2009<br>Financial instruments: IAS 32, IAS 39 and IFRS 7 explained | 5th edition (June 2009). Guidance on how to apply these complex Standards, including illustrative examples and interpretations. |
| Standard-specific guides:<br>– IFRS 2<br>– IFRS 3 & IAS 27<br>– IFRS 5<br>– IAS 34 | Detailed guidance for specific Standards, with explanations of the requirements, guidance for application, and discussion of evolving literature. |

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