

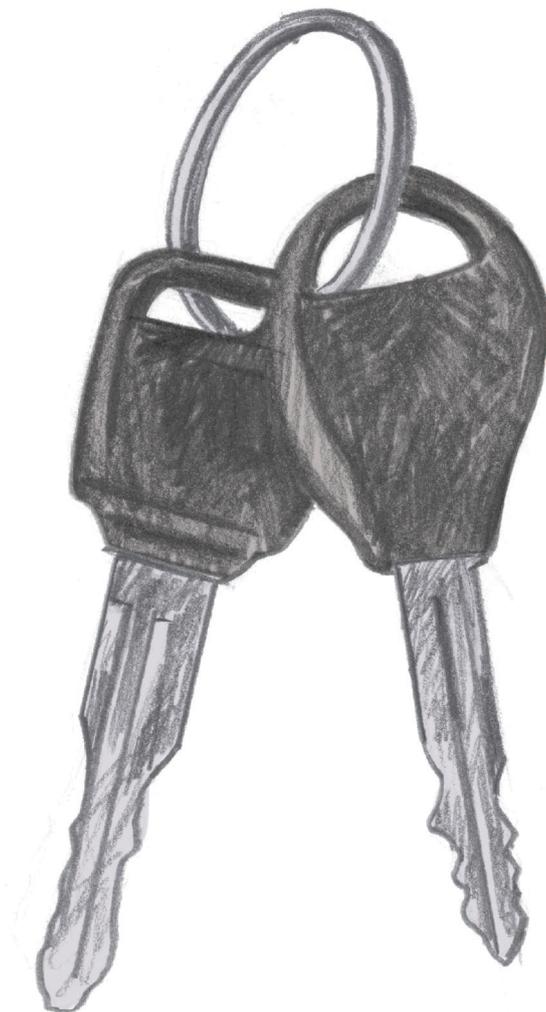


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The Road to IFRS – a practical guide to IFRS 1 and first-time adoption



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Introduction

The Road to IFRS

The benefits of global standards are widely acknowledged with over 100 countries now applying International Financial Reporting Standards (IFRSs). Many countries made this switch recently while others are still in the process of transition from local GAAP. Experience has shown that, for companies, the conversion to IFRSs is a major change both for the finance function and for the wider business. Many more companies will face this challenge in future – due for example to more countries adopting IFRSs, initial public offerings and changes of ownership.

The International Accounting Standards Board (IASB) recognised the need for guidance some time ago and, in 2003, published IFRS 1 ‘First-time Adoption of International Financial Reporting Standards’ (IFRS 1). Since then IFRS 1 has been amended several times.

IFRS 1 covers the application of IFRSs in a company’s first IFRS financial statements. It starts with the basic premise that an entity applies IFRSs for the first time on a fully retrospective basis. However, acknowledging the cost and complexity of that approach, IFRS 1 then provides numerous exemptions in areas where retrospective application would be too burdensome or impractical. In planning the conversion, management must develop a detailed and specific understanding of IFRS 1’s implications on their business. Questions to consider include:

- when is retrospective restatement required and what will this involve?
- what are the exemptions in IFRS 1 and how should we decide which to take up?
- what information is needed in our first IFRS financial statements?
- how does IFRS 1 affect the timing of our conversion and reporting?

Fortunately, the member firms within Grant Thornton International Ltd (Grant Thornton International) – one of the world’s leading organisations of independently owned and managed accounting and consulting firms – have gained extensive insights into the more problematic aspects of first-time adoption of IFRS. Grant Thornton International, through its IFRS team, develops general guidance that supports its member firms’ commitment to high quality, consistent application of IFRSs. We are pleased to share these insights by publishing this guide ‘The Road to IFRS – A practical guide to IFRS 1 and first-time adoption’ (the guide). The guide reflects the collective experience of Grant Thornton International’s IFRS team and member firm IFRS experts. It explains IFRS 1’s key implementation issues and includes interpretational guidance in the more problematic areas. The guide also includes several examples illustrating the Standard’s disclosure and presentation requirements. We have not attempted to cover every possible transaction but have focused instead on areas that have proved to be challenging in practice.

Latest version of IFRS 1

IFRS 1 has been amended many times since 2003 in order to clarify issues raised in practice, introduce new exemptions and accommodate changes to other IFRSs. In this guide, subject to an exception for IFRS 9 ‘Financial Instruments’ (see note below), references and examples are based on the latest versions as at June 2012 of:

- IFRS 1
- all other IFRSs, including those that are not yet in mandatory effect.

Important note

IAS 39 and IFRS 9

The IASB is part way through a process of replacing IAS 39 'Financial Instruments: Recognition and Measurement' (IAS 39) with IFRS 9 'Financial Instruments' (IFRS 9). IFRS 9 is being developed in stages and is not yet complete. In addition, some changes are expected to be made to the chapters of IFRS 9 that have already been published. The current version of IFRS 9 is mandatory for annual periods beginning on or after 1 January 2015 (early application is permitted).

In view of the status of IFRS 9 and its effective date, the guide has been written on the assumption that a first-time adopter will apply IAS 39 rather than IFRS 9. An entity that adopts IFRS 9 should refer directly to the published version of IFRS 1 where applicable.

- **Appendix I** includes a list of mandatory and optional exemptions from full retrospective application of IFRSs
- **Appendix II** provides further application guidance.

The focus of this guide is on the accounting aspects of first-time adoption. Adopting IFRSs goes beyond pure accounting – affecting for example information systems, contractual arrangements and communication to investors and other stakeholders. In planning its transition, management should ensure that sufficient, timely attention is given both to the accounting and to these broader business implications.

Grant Thornton International Ltd
October 2012

Using the guide

The guide is organised as follows:

- **Section A** addresses the scope and objectives of IFRS 1 and summarises its main principles
- **Section B** discusses the implications of preparing an IFRS opening statement of financial position, focusing on recognition and measurement principles (IFRS accounting policies) and the date of transition
- **Section C** discusses the exemptions to full retrospective application of IFRSs illustrating the practical implications with several examples
- **Section D** addresses the presentation and disclosure requirements of IFRS 1



Contents

Introduction	i
A. IFRS 1 principles in brief	1
1 Background and objectives	1
2 When does IFRS 1 apply?	2
2.1 First IFRS financial statements	2
2.2 Application of IFRS 1 more than once	3
2.3 Interim financial reports	3
B. Opening statement of financial position	4
1 Preparing an opening statement of financial position	4
1.1 The date of transition	4
1.2 Recognition and measurement in the opening statement of financial position	6
2 Accounting policies	6
2.1 Transitional provisions in other IFRSs do not apply	6
2.2 Changes to IFRSs effective later than the first reporting date	6
2.3 Interim financial reports	7
3 Where does the adjustment entry go?	8
C. Exemptions from full retrospective application	9
1 Prospective application	9
2 Optional exemptions	10
2.1 Business combinations	10
2.2 Goodwill	16
2.3 Deemed cost	17
2.4 Employee benefits	21
2.5 Cumulative translation differences	22
2.6 Compound financial instruments	22
2.7 Assets and liabilities of subsidiaries, associates and joint ventures	23
2.8 Designation of previously recognised financial instruments	26
2.9 Share-based payment transactions	26
2.10 Insurance contracts	28
2.11 Decommissioning liabilities included in the cost of property, plant and equipment	28
2.12 Leases	29
2.13 Fair value measurement of financial assets or financial liabilities at initial recognition	30
2.14 Service concession arrangements	31
2.15 Borrowing costs	31
2.16 Investments in subsidiaries, joint ventures and associates	32
2.17 Transfers of assets from customers	33
2.18 Extinguishing financial liabilities with equity instruments	33
2.19 Stripping costs in the production phase of a surface mine	33
2.20 Severe hyperinflation	34
2.21 Joint arrangements	34

3	Mandatory exemptions	36
3.1	Derecognition of financial assets and financial liabilities	36
3.2	Hedge accounting	36
3.3	Estimates	37
3.4	Consolidation and non-controlling interests	38
3.5	Government loans	40
4	Future developments	41
D.	Presentation and disclosure	42
1	General requirements	42
2	Primary statements and comparative information	42
2.1	Historical summaries	43
2.2	Related notes	43
3	Explanation of transition to IFRSs	44
3.1	Reconciliations of equity	44
3.2	Reconciliation of total comprehensive income	45
3.3	Example of reconciliations	46
3.4	Presentation differences	49
3.5	Statement of cash flows	49
3.6	Impairments	49
4	Previous GAAP errors	50
5	Other disclosures	50
6	IFRS 1 exemptions applied	50
7	Interim financial reports	51
Appendix I.	Current effective exemptions	53
1	Mandatory exemptions	53
2	Optional exemptions	54
3	Optional short term exemptions	54
Appendix II.	Selected application issues	56
1	Introduction	56
2	Intangible assets – capitalisation of development costs	56
3	Leases	57
4	Financial instruments	57
4.1	Recognition	57
4.2	Measurement	57
4.3	Presentation of financial instruments as liabilities or equity	59
4.4	Embedded derivatives	59
5	Hedge accounting	60
5.1	Reflecting hedges in the opening statement of financial position	60
5.2	Subsequent accounting after the date of transition	64
6	Income taxes	66
6.1	IAS 12 initial recognition exemption	66
6.2	Deferred tax on share options granted before 7 November 2002	67
6.3	Intangible assets acquired in a pre-transition date business combination	67
7	Business combinations	68
7.1	Double-counting of fair value adjustments within goodwill	68
7.2	Intangible assets acquired in a past business combination	68
8	Venture capital organisations and investments in associates	70
9	Pre-transition share-based payments costs	70

A. IFRS 1 principles in brief

IFRS 1 sets out the procedures that a first-time adopter must follow on first-time adoption of IFRSs. This section discusses the objectives and scope of the standard and also summarises the main principles in IFRS 1.

IFRS 1 at a glance

- A. The main principle of IFRS 1 is to present the first IFRS financial statements using the accounting policies effective at the end of the first IFRS reporting period throughout all periods presented. For example, a company using IFRSs for the first time in 2012 with a December year-end would use the accounting policies in force at 31 December 2012 and apply those policies retrospectively. Therefore the financial statements are presented as if the first-time adopter had always presented IFRS financial statements (important exemptions apply).
- B. The first-time adopter establishes its date of transition, which 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.
- C. At the date of transition the first-time adopter prepares an opening statement of financial position. This is the starting point for its accounting under IFRSs.
- D. In the opening statement of financial position, the first-time adopter applies its IFRS accounting policies in recognising and measuring all assets and liabilities, and if appropriate reclassifies items recognised under previous generally accepted accounting principles (GAAP) as another type of asset, liability or component of equity. The accounting policies are based on IFRSs effective at the end of its first IFRS reporting period (important exemptions apply).
- E. In preparing the opening statement of financial position, the first-time adopter may choose the optional exemptions from retrospective application. The first-time adopter applies the mandatory exemptions in all applicable cases.
- F. A first-time adopter prepares reconciliations between previous GAAP and IFRSs, and discloses these reconciliations in its first IFRS financial statements (and interim reports, if applicable). The entity complies with other note disclosures in IFRS 1 in addition to those required by other IFRSs.

1 Background and objectives

IFRS 1 was first published in June 2003. It has been amended many times since in order to clarify issues raised in practice, introduce new exemptions and accommodate changes to other IFRSs (including an extensive reorganisation in November 2008). It sets out most of the transitional requirements that an entity applies when it first adopts IFRSs and also specifies various disclosures to explain the effects of transition to IFRSs.

The objectives of IFRS 1 are to ensure that an entity's first IFRS financial statements (or interim reports that cover part of the first IFRS reporting period) contain information that:

- is transparent for users
- is 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.

Put another way, IFRS 1 aims to strike a balance between the ideal of full retrospective application (ie applying IFRSs in the first year as though the entity has always done so), and the cost of applying that approach. IFRS 1 sets out a limited but significant range of exemptions from retrospective application which are very important in practice. These are discussed in section C.

2 When does IFRS 1 apply?

IFRS 1.2 states that:

“An entity shall apply this IFRS in:

- (a) its first IFRS financial statements; and
- (b) each interim financial report, if any, that it presents in accordance with IAS 34 ‘Interim Financial Reporting’ for part of the period covered by its first IFRS financial statements.”

2.1 First IFRS financial statements

An entity applies IFRS 1 in its first IFRS financial statements (and each interim financial report that covers part of the period of those first IFRS financial statements). It is therefore essential to identify those financial statements, which are defined as:

“The first **annual** financial statements in which an entity adopts International Financial Reporting Standards (IFRSs), by an explicit and unreserved statement of compliance with IFRSs” (IFRS 1.Appendix A) [emphasis added].

The most common example of an entity’s first IFRS financial statements is when an entity presented its most recent financial statements under local GAAP or other requirements that differ from IFRSs. This will be the case for most first-time adopters.

The standard includes some other examples of first IFRS financial statements, which emphasise the importance of the explicit and unreserved statement of compliance with IFRSs. For example, IFRS 1 applies where the entity presented its most recent financial statements in conformity with IFRSs in all respects, except that the financial statements did not contain an explicit and unreserved statement of compliance with IFRSs. Other examples are shown below:

Example A.1: First IFRS financial statements

- A. Entity A did not present financial statements for previous periods. Entity A’s annual financial statements include an explicit and unreserved statement of compliance with IFRSs. The financial statements of entity A are the entity’s first IFRS financial statements, and entity A applies IFRS 1 (IFRS 1.3(d)).
- B. Entity B’s previous financial statements contained an explicit statement of compliance with some, but not all, IFRSs. The financial statements of entity B for the year contain an explicit and unreserved statement of compliance with all IFRSs. The financial statements for the year are the entity’s first IFRS financial statements and entity B applies IFRS 1 (IFRS 1.3(a)(iii)).
- C. Entity C’s financial statements for the previous year contained an explicit and unreserved statement of compliance with IFRSs, but the auditors presented a qualified audit report. The financial statements of entity C for this year are not the entity’s first IFRS financial statements, and IFRS 1 does not apply (IFRS 1.4(c)).
- D. Entity D presented its prior year financial statements under national requirements and those financial statements contained an explicit and unreserved statement of compliance with IFRSs. This year’s financial statements also contain an explicit and unreserved statement of compliance with IFRSs. The financial statements of entity D for this year are not the entity’s first IFRS financial statements, and IFRS 1 does not apply (IFRS 1.4(b)).

The examples make clear that the definition is applied strictly. As noted above, making an explicit and unreserved statement of compliance with IFRSs is a key factor, along with the absence of this statement in the previous financial statements. It follows that a set of financial statements can only be the first IFRS financial statements if they comply with all requirements in IFRSs (including disclosures).

2.2 Application of IFRS 1 more than once

An entity applies IFRS 1 when it adopts IFRSs for the first time. It therefore applies IFRS 1 in its transition to IFRSs and cannot generally apply it again. However, an entity might have adopted IFRSs in the past but later switched to another financial reporting framework (eg local generally accepted accounting practice or GAAP). If the entity subsequently re-adopts IFRSs in a future period it can either:

- apply IFRS 1 or
- apply IFRSs retrospectively in accordance with IAS 8 ‘Accounting Policies, Changes in Accounting Estimates and Errors’ (IAS 8) as if the entity had never stopped applying IFRSs, in which case it should disclose the reason why it has elected to apply IFRSs retrospectively.

Irrespective of whether the entity decides to apply IFRS 1 or IAS 8, it shall disclose the reason why it previously stopped applying IFRSs and the reason why it is re-adopting IFRSs (IFRS 1.23A).

2.3 Interim financial reports

It is important to note that a first-time adopter’s interim financial reports for part of the period covered by the first IFRS financial statements (for example the first six months) presented under IAS 34 ‘Interim Financial Reporting’ (IAS 34) should also follow the requirements in IFRS 1. However, IFRS 1 does not require a first-time adopter to present an interim report, it only requires additional disclosures in the interim report if one is presented. These disclosure requirements are further discussed in section D.

B. Opening statement of financial position

Summary of requirements

- A. The first-time adopter establishes its date of transition to IFRSs, which 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.
- B. At the date of transition the first-time adopter prepares an opening statement of financial position. This is the starting point for its accounting under IFRSs.
- C. In the opening statement of financial position, the first-time adopter applies its IFRS accounting policies in recognising and measuring all assets and liabilities, and if appropriate reclassifies items recognised under previous GAAP as another type of asset, liability or component of equity (subject to important exemptions). The accounting policies are based on IFRSs effective or available for early adoption at the end of its first IFRS reporting period. For interim reports, we believe the policies should be based on IFRSs in existence at the date of authorisation of the report.

1 Preparing an opening statement of financial position

The requirement for an opening statement of financial position is stated in IFRS 1.6:

“An entity shall prepare and present an opening IFRS statement of financial position at the date of transition to IFRSs. This is the starting point for its accounting in accordance with IFRSs.”

This opening statement of financial position is prepared based on IFRSs in mandatory force (or available for early application) at the end of the first annual reporting period under IFRSs, except where IFRS 1 permits or requires otherwise.

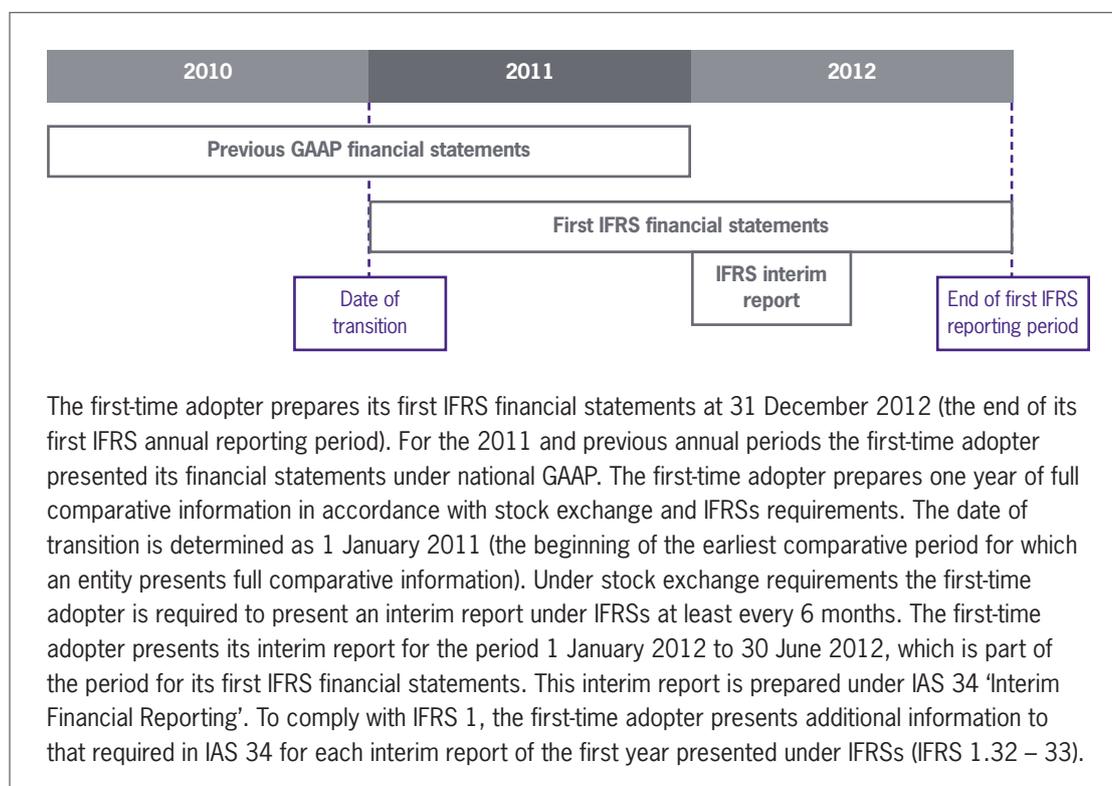
1.1 The date of transition

The date of transition is the starting point for the entity’s accounting under IFRSs. The date of transition is defined in IFRS 1 as:

“The beginning of the earliest period for which an entity presents **full** comparative information under IFRSs in its first IFRS financial statements” (IFRS 1.Appendix A) [emphasis added]

For companies presenting only one year of full comparative information, the date of transition will be the beginning of the (only) full comparative period. Consider the following example:

Example B.1: The date of transition



Presenting one year of full comparative information is the norm under IFRSs. It should however be noted that IAS 1 'Presentation of Financial Statements' (IAS 1) requires an additional statement of financial position in a regular set of IFRS financial statements at the beginning of the earliest comparative period presented when an entity makes a retrospective restatement. In a first-time adopter's first IFRS financial statements, IFRS 1.21 requires presentation of at least two comparative statements of financial position, and one comparative period for the other primary financial statements.

IFRS 1 paragraph 21

To comply with IAS 1, an entity's first IFRS financial statements shall include at least three statements of financial position, two statements of profit or loss and other comprehensive income, two separate statements of profit or loss (if presented), two statements of cash flows and two statements of changes in equity and related notes.

This additional statement of financial position does not bring forward the date of transition. This is because that date is defined as the beginning of the earliest period for which an entity presents **full** comparative information under IFRSs.

The requirement to present an additional statement of financial position applies to all first IFRS financial statements where IAS 1 is applied. This is discussed further in section D.2.

If an entity is required to present full comparative information for two periods, the date of transition is brought forward. Consider example B.2 below.

Example B.2: Two full comparative periods required by national law

Entity A is presenting its first IFRS financial statements in 2012 with a reporting date of 31 December 2012. Entity A is required by national law to present full comparative information under IFRSs for two annual periods. The date of transition is 1 January 2010, which is the beginning of the earliest period where an entity presents full comparative information under IFRSs. In this situation, the transition date is 3 years before the reporting date because of the requirement by national law for two full comparative periods.

1.2 Recognition and measurement in the opening statement of financial position

The general rule in IFRS 1 is that a first-time adopter develops accounting policies that conform with IFRSs effective at the end of its first IFRS reporting period. It then applies those policies both in its opening statement of financial position and throughout all periods presented. In the absence of any relaxation of this default approach, converting the opening statement of financial position from local GAAP to IFRSs would require a complete, retrospective restatement of assets, liabilities and equity in conformity with the version (or versions) of IFRSs in force at the first reporting date. However, IFRS 1 permits or requires numerous exemptions to the general rule. These exemptions, which are of great practical importance, are considered in section C.

When these exemptions do not apply, IFRS 1.10 states that in preparing the opening statement of financial position a first-time adopter:

- recognises all assets and liabilities whose recognition is required by IFRSs
- does not recognise items as assets or liabilities if IFRSs do not permit such recognition
- reclassifies items that it recognised under previous GAAP as one type of asset, liability or component of equity but are a different type of asset, liability or component of equity under IFRSs and
- applies IFRSs in measuring all recognised assets and liabilities.

In other words, in the absence of an exemption, the opening statement of financial position is prepared as if the first-time adopter had always applied the currently effective version of IFRSs.

2 Accounting policies

In preparing the opening statement of financial position a first-time adopter applies accounting policies that comply with all IFRSs effective at the end of its first IFRS reporting period. It uses these accounting policies throughout all periods presented in the first IFRS financial statements (IFRS 1.7). In other words, a first-time adopter is not permitted to apply different versions of IFRSs that were effective at earlier dates (IFRS 1.8). In the absence of an IFRS that specifically applies to a transaction, the hierarchy in IAS 8 for selection of accounting policies applies both for the interim reports and for the annual financial statements.

2.1 Transitional provisions in other IFRSs do not apply

Transitional and effective date provisions in other IFRSs

“Transitional provisions” in IFRSs are requirements governing **how** an entity moves from a previous version of an IFRS to the latest version. Where a new or revised IFRS does not contain transition provisions, the general rules in IAS 8 apply. These can be summarised as retrospective application subject to some practicality constraints. Where a new or revised IFRS includes transitional requirements, these typically specify the extent to which prospective rather than retrospective application is required and sometimes cover more detailed matters.

Transitional provisions should not be confused with effective date provisions (see paragraph 2.2 below). Effective date provisions set out **when** (rather than how) a new or revised IFRS is applied. They typically specify that the new requirement must be applied in an annual period beginning on or after a certain date. Effective date requirements also address whether early application is permitted and any conditions attached to early adoption. For example, an entity that early adopts one new requirement may also be required to adopt other related requirements.

The transitional provisions in other IFRSs apply only to entities that already apply IFRSs. The transitional provisions do not apply to a first-time adopter except where specified in IFRS 1 (IFRS 1.9).

2.2 Changes to IFRSs effective later than the first reporting date

In many cases, a first-time adopter will find that more than one IFRSs (or version of an IFRSs) is available at the end of the first IFRS reporting period. This occurs when the IASB has issued a new or revised standard which is not yet mandatory at that date but which permits early application. In this situation, a first-time adopter is permitted to develop its accounting policies using either the previous IFRS or the new IFRS (or version).

For example, in May 2011 the IASB published IFRS 10 ‘Consolidated Financial Statements’ (IFRS 10), IFRS 11 ‘Joint Arrangements’ (which replaces IAS 31 ‘Interests in Joint Ventures’), IFRS 12 ‘Disclosure of Interests in Other Entities’, an amended version of IAS 27 ‘Separate Financial Statements’ and an amended version of IAS 28 ‘Investments in Associates and Joint Ventures’ (the ‘consolidation package’). The package takes mandatory effect for annual periods beginning on or after 1 January 2013. Earlier application is permitted provided that the entity applies the entire package.

If a first-time adopter presents its first IFRS financial statements at 31 December 2012, it can apply the previous consolidation standards. Alternatively, it can apply the consolidation package in its entirety. IFRS 1.8 confirms that a first-time adopter may apply a new IFRS that is not yet mandatory if that IFRS permits early application.

In practice, a first-time adopter will often find it more convenient to apply the new standard or the latest version of a standard to avoid having an accounting policy change in the following year. However, in some circumstances using an earlier standard or version (when permitted) might be preferable. The options are illustrated in the following example:

Example B.3: Impact of new standards

Background

Entity A is a first-time adopter and its first IFRS reporting period ends on 31 December 2012. Entity A presents full comparative information in those financial statements for one year. Therefore, its date of transition to IFRSs is 1 January 2011. Entity A presented financial statements under its previous GAAP annually to 31 December each year up to, and including, 31 December 2011.

Entity A is required to apply the IFRSs effective for periods ending on 31 December 2012 in preparing and presenting:

- (a) its opening IFRS statement of financial position at 1 January 2011, and
- (b) its statement of financial position for 31 December 2012, and statements of comprehensive income, changes in equity and cash flows for the year to 31 December 2012 and related notes (including comparative information).

If a new IFRS is not yet mandatory but permits early application, entity A is permitted, but not required, to apply that IFRS in its first IFRS financial statements (IFRS 1.8).

Examples of effective and optional standards in Entity A's first IFRS financial statements include:

- IFRIC 19 ‘Extinguishing Financial Liabilities with Equity Instruments’ (IFRIC 19) becomes effective for annual periods beginning on or after 1 July 2010. Therefore, IFRIC 19 must be applied
- IFRS 13 ‘Fair Value Measurement’, the ‘consolidation package’ referred to above and some important changes to IAS 19 ‘Employee Benefits’ all become effective for annual periods beginning on or after 1 January 2013. Entity A may therefore either apply these new standards or the previous standards or versions in its first IFRS financial statements. However, if it decides to apply the previous versions it would need to revise its accounting policies in the next annual period ending 31 December 2013
- IFRS 9 ‘Financial Instruments’ (IFRS 9) becomes effective for annual periods beginning on or after 1 January 2015. The annual period in which entity A presents its first IFRS financial statements begins 1 January 2012. Therefore, IFRS 9 is not mandatorily effective at 31 December 2012. However, entity A may elect to apply IFRS 9 as the standard permits early application.

2.3 Interim financial reports

When publishing interim financial reports covering part of the first IFRS annual reporting period, a first-time adopter may not always be certain of the IFRSs that will be mandatorily effective or available for early application at the end of the annual period. This can happen as a result of the IASB making one of its occasional ‘fast-track’ changes to IFRSs, or publication of a new IFRS or amendment after publication of the interim report but before the end of the first IFRS reporting period. Management may also decide to change an accounting policy after release of the interim report, for example by early application of a new IFRS (see section D.5).

We consider that the accounting policies used in an interim report should reflect only the IFRSs in existence at the date of authorisation of that interim financial report. In other words, a first-time adopter should not anticipate future pronouncements – for example by using an exposure draft it expects to be approved before year-end as the basis for an accounting policy in its interim report.

The basic approach to accounting policies for interim financial reports can be illustrated with the following example:

Example B.4: Interim financial report

The facts are the same as in example B.3 above but entity A is considering which version of IFRSs to apply in preparing an interim report covering the six months to 30 June 2012 (the first six months of its first annual IFRS reporting period).

An amendment to an IFRS becomes effective for annual periods beginning on or after 1 January 2012. The annual period in which entity A presents its first IFRS interim financial report begins on 1 January 2012. Therefore, the amendment is effective for the annual reporting period which this interim period is part of. Accordingly, the amendment should be applied when entity A publishes its interim financial report.

3 Where does the adjustment entry go?

When a first-time adopter restates assets, liabilities and equity in its opening statement of financial position a difference between the carrying amounts under previous GAAP and those under IFRSs will arise. For example, a first-time adopter may remeasure investment properties to fair value under IFRSs or restate some of its financial assets. Where should the adjustment entry be recorded?

IFRS 1.11 states that a first-time adopter should recognise those adjustments directly in retained earnings or, if appropriate, another category of equity. This is appropriate because the differences relate to events that occurred before the date of transition to IFRSs and should not therefore affect profit or loss or other comprehensive income for the reporting period. As an exception to this general requirement, certain adjustments to intangible assets acquired in prior business combinations result in a restatement of goodwill (this is discussed further in section C).

The circumstances in which a first-time adopter would be required to recognise the adjustments in another category of equity depend on the IFRSs applicable to the asset or liability in question. For example, where a first-time adopter chooses the revaluation model in IAS 16 'Property, Plant and Equipment' (IAS 16) as its accounting policy, it presents the cumulative revaluation surplus as a separate component of equity under the heading of revaluation surplus (IAS 16.39).

C. Exemptions from full retrospective application

Summary of requirements

- A. In preparing the opening statement of financial position the first-time adopter applies the IFRS accounting policies effective at the end of the first IFRS reporting period. The general principle is to apply the IFRS accounting policies retrospectively in the opening statement of financial position.
- B. IFRS 1, however, establishes important exemptions from full retrospective application in areas where the IASB acknowledged that the costs of retrospective application exceed the benefits to users and where retrospective application may be impracticable. These are divided into:
 - a. Mandatory exemptions
 - b. Optional exemptions.
- C. The first-time adopter may choose any of the optional exemptions from retrospective application in IFRS 1. The first-time adopter applies the mandatory exemptions in all cases.

1 Prospective application

IFRS 1 establishes two categories of exemptions from full retrospective application of IFRSs – optional exemptions and mandatory exemptions. The mandatory exemptions generally prohibit full retrospective application, while the optional exemptions permit a first-time adopter to choose to apply certain IFRS accounting policies prospectively from the date of transition. The importance of these provisions became clear when IFRSs were adopted in the European Union and many companies applied the exemptions. The exemptions continue to be relevant for current first-time adopters.

The exemptions are discussed further in this section and can be summarised as follows (a reference is made to the relevant section of the guide):

Mandatory and optional exemptions from full retrospective application

Mandatory exemptions	Optional exemptions
<ul style="list-style-type: none"> • Derecognition of financial assets and financial liabilities (3.1) • Hedge accounting (3.2) • Estimates (3.3) • Consolidation and non-controlling interests (3.4) • Government loans (3.5) 	<ul style="list-style-type: none"> • Business combinations (2.1 and 2.2) • Deemed cost (2.3) • Employee benefits (2.4) • Cumulative translation differences (2.5) • Compound financial instruments (2.6) • Assets and liabilities of subsidiaries, associates and joint ventures (2.7) • Designation of previously recognised financial instruments (2.8) • Share-based payment transactions (2.9) • Insurance contracts (2.10) • Decommissioning liabilities included in the cost of property, plant and equipment (2.11) • Leases (2.12) • Fair value measurement of financial assets or financial liabilities at initial recognition (2.13) • Service concession arrangements (2.14) • Borrowing costs (2.15) • Investments in subsidiaries, joint ventures and associates (2.16) • Transfers of assets from customers (2.17) • Extinguishing financial liabilities with equity instruments (2.18) • Stripping costs in the production phase of a surface mine (2.19) • Severe hyperinflation (2.20) • Joint arrangements (2.21) <p>Optional short term exemptions</p> <ul style="list-style-type: none"> • Disclosures of financial assets (Appendix I.3) • Disclosures about transfers of financial assets (Appendix I.3) • Employee benefits (Appendix I.3)

A list of the effective dates of the current exemptions is set out in Appendix I.

2 Optional exemptions

IFRS 1.18 permits a first-time adopter to elect to use one or more exemptions from full retrospective application. These exemptions are specific and complete – a first-time adopter cannot avail itself of further exemptions by analogy to those set out. Where a first-time adopter takes one of these exemptions, it uses an alternative accounting method specified in IFRS 1 rather than applying the ‘normal’ IFRSs requirement retrospectively. This assists the first-time adopter because applying the ‘normal’ IFRSs requirement retrospectively might be unduly costly or impracticable. Management should therefore carefully consider the impact of the optional exemptions in IFRS 1. The exemptions are discussed in the following paragraphs.

Some of the exemptions refer to fair value, IFRS 1 defines fair value as ‘the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.’ (IFRS 1.A).¹

2.1 Business combinations

2.1.1 First-time adopters can choose not to restate a past business combination

In practice, perhaps the most important exemption is for business combinations that occurred prior to the date of transition to IFRSs (past business combinations). Broadly this exemption allows a choice between restating past business combinations in accordance with IFRS 3 ‘Business Combinations’ (IFRS 3), or applying a more limited restatement approach. The options and the more limited restatement approach are described in Appendix C to IFRS 1 (IFRS 1.C).

¹ The definition of fair value was amended by IFRS 13 ‘Fair Value Measurement’ (IFRS 13). IFRS 13 is effective for annual periods beginning on or after 1 January 2013, earlier application is permitted. A first-time adopter that elects not to apply IFRS 13 should apply the applicable guidance on fair value in other IFRSs.

Limited restatement approach

It is important to emphasise that taking up the exemption not to restate past business combinations does not result in carrying forward all the same amounts recognised under previous GAAP. The alternative to full IFRS 3 restatement starts with the previous GAAP classification and carrying amounts but various adjustments are required. This alternative is referred to in this guide as a limited restatement approach.

The exemption – which is widely applied in practice – is necessary because many first-time adopters do not have all the information necessary to apply IFRS 3 to past business combinations.

According to IFRS 1.C a first-time adopter has the following options:

- apply IFRS 3 retrospectively to all past business combinations
- apply IFRS 3 to restate a past business combination and any later business combinations
- not apply IFRS 3 to any past business combinations.

All business combinations that occur after the date of transition must be accounted for in accordance with IFRS 3.

To illustrate the options (assuming the first-time adopter does not wish to restate all past business combinations), consider a first-time adopter with a reporting date of 31 December 2012 and a date of transition of 1 January 2011:

- the first-time adopter may elect not to apply IFRS 3 to past business combinations that occurred before 1 January 2011. In that case the first-time adopter follows the requirements set out in Appendix C to IFRS 1 which can be described as a limited restatement approach (IFRS 1.C4)
- the first-time adopter may elect to restate an earlier business combination to comply with IFRS 3. In that case it must also restate all business combinations that took place after the date of that business combination. For example, the first-time adopter may elect to restate a business combination occurring at 1 February 2010 and accordingly it must also restate every other business combination from 1 February 2010 to the date of transition (IFRS 1.C1)². In effect 1 February 2010 becomes the designated effective date of IFRS 3. The first-time adopter follows the limited restatement approach set out in IFRS 1.C4 for all business combinations that occurred before 1 February 2010.

Which version of IFRS 3 should be applied?

IFRS 3 (2008) is effective for business combinations in periods beginning on or after 1 July 2009. Earlier application is permitted but IFRS 3 (2008) cannot be applied prior to the beginning of an annual period beginning on or after 30 June 2007. IFRS 3 (2008) differs from the previous version, IFRS 3 (2004), in various important respects.

As noted above, a first-time adopter may apply IFRS 3 to restate a past business combination and any later business combinations. If a first-time adopter elects to restate business combinations before 30 June 2007, which version of IFRS 3 should be applied?

In our view, the entity should apply IFRS 3 (2008). We believe the reference to IFRS 3 in IFRS 1.C1 should, in the absence of explicit guidance, be read as a reference to the latest version. Using the current version also accords with IFRS 1's general principles and will improve consistency.

The exemption for past business combinations also applies to past acquisitions of investments in associates and of interests in joint ventures. Furthermore, the date selected for IFRS 1.C1 applies equally for all such acquisitions (IFRS 1.C5).

² An entity shall also apply IFRS 10 from that date

2.1.2 The exemption can only be applied for 'business combinations'

In our view, a first-time adopter can only apply the exemption to transactions that meet IFRS 3's definition of a business combination. The exemption is not therefore applicable to acquisitions of assets (including entities holding one or more assets) that do not constitute a business.

Example C.1: Asset purchase that is not a business

Prior to its transition date, a first-time adopter Q acquired a group of assets. Under previous GAAP, this transaction was treated as a business combination. After analysing the circumstances, it was clear to the management of Q that under IFRSs this transaction should be treated as an asset purchase and not a business combination. Therefore, the exemption is not available to Q in relation to this asset purchase. The first-time adopter Q restates the asset purchase, and any goodwill recognised under previous GAAP is removed in the opening statement of financial position. There may, however, be other exemptions available to Q in relation to the asset purchase, such as treating fair value as deemed cost.

Business combinations outside the scope of IFRS 3

Two types of transactions that may meet IFRS 3's definition of a business combination are nonetheless outside the scope of IFRS 3 - the formation of a joint venture and a combination of entities or businesses under common control. IFRSs do not include any other specific guidance on these transactions. In our view, IFRS 1.C applies to these transactions in the same way as to business combinations within IFRS 3's scope. Accordingly the first-time adopter can choose between full restatement under IFRS 3 or the more limited restatement approach.

2.1.3 Accounting for past business combinations to which IFRS 3 is not applied (the limited restatement approach)

The consequences of not applying IFRS 3 to past business combinations are dealt with in IFRS 1.C4. Although these past business combinations are not fully restated, there are rules for recognition and measurement of assets acquired and liabilities assumed in a past business combination that must be followed by the first-time adopter (the limited restatement approach). In short, these requirements deal with the following:

- classification of the business combination (as an acquisition by the legal acquirer, a reverse acquisition by the legal acquiree, or a uniting of interests) [paragraph 2.1.4]
- the assets and liabilities acquired or assumed in the past business combination that are included in (or excluded from) the opening statement of financial position [paragraph 2.1.5]
- measurement in the opening statement of financial position of assets and liabilities acquired or assumed in the past business combination [paragraph 2.1.6]
- goodwill recognised in the past business combination [paragraph 2.2].

2.1.4 Classification of past business combinations

In accordance with IFRS 1.C4(a) the first-time adopter retains the same classification adopted in its previous GAAP financial statements (as an acquisition by the legal acquirer, a reverse acquisition or a uniting of interests). In other words the first-time adopter does not go back to the acquisition date and apply the rules in IFRS 3 to determine the acquirer. If the transaction was accounted for as a merger or uniting of interests under previous GAAP, the first-time adopter does not restate the accounting using the purchase method. However, the requirements for recognising and measuring assets and liabilities in IFRS 1.C are still applicable for the first-time adopter in relation to assets and liabilities acquired or assumed in that business combination.

2.1.5 Recognition or derecognition in the opening statement of financial position

The effect of not restating a past business combination does not mean that all (or only) assets and liabilities recognised under previous GAAP are included (or excluded) in the IFRS opening statement of financial position. IFRS 1.C4 states that:

- some items recognised under previous GAAP may need to be derecognised under IFRSs and
- some items not recognised under previous GAAP may need to be recognised under IFRSs.

The assets and liabilities to be recognised in the opening statement of financial position depend in part on whether items were recognised under previous GAAP. Accordingly, the rules are best examined by considering in turn items recognised under previous GAAP and items not so recognised.

The following paragraphs consider only recognition of assets and liabilities in the opening statement of financial position. Measurement is dealt with in paragraph 2.1.6.

2.1.5.1 Items that were recognised under previous GAAP

IFRS 1.C4(b) states that the first-time adopter recognises all assets acquired and liabilities assumed in a past business combination in its opening statement of financial position, with the exception of certain financial assets and financial liabilities derecognised under previous GAAP (see paragraph 3.1). In accordance with this requirement the first-time adopter continues to recognise assets such as property, plant and equipment and receivables (for example) that would typically have been recognised under previous GAAP and also qualify for recognition under IFRSs.

The first-time adopter should therefore exclude (derecognise) from its opening statement of financial position any item that was recognised under previous GAAP that does not qualify for recognition under IFRSs (IFRS 1.C4(c)). The resulting changes are accounted for as follows:

- if the first-time adopter recognised an intangible asset in a past business combination under previous GAAP, and the asset does not qualify for recognition under IFRSs, it reclassifies that item to goodwill (IFRS 1.C4(c)(i))
- all other changes are recognised in retained earnings (IFRS 1.C4(c)(ii)).

In assessing whether an asset or liability qualifies for recognition in accordance with IFRSs, in our view an item qualifies if it is recognised in IFRS 3 business combination accounting even if it would not be recognised in the acquiree's individual IFRS financial statements. This basis of recognition is slightly different and broader than the requirements for recognition of items not recognised under previous GAAP business combination accounting – see paragraph 2.1.5.2 below.

A common example of a 'liability' that might have been recognised under previous GAAP and would not be recognised under IFRSs is a provision for a planned restructuring that is not sufficiently advanced to give rise to an obligation in accordance with applicable IFRSs. Another example is an 'asset' recognised for past expenditure on advertising and promotion. The extent of differences is of course dependent entirely on differences between previous GAAP and IFRSs.

To illustrate the requirements on derecognition, consider the example below:

Example C.2: Items excluded from the opening statement of financial position

Background

A first-time adopter acquired a subsidiary before the date of transition to IFRSs. It has elected to use the exemption not to apply IFRS 3 to past business combinations.

Under previous GAAP the first-time adopter recognised:

- (a) a restructuring provision that does not qualify for recognition under IFRSs. This increased goodwill.
- (b) an intangible asset that does not qualify for recognition under IFRSs. This reduced goodwill.

Application of requirements

In its opening IFRS statement of financial position, the first-time adopter:

- (a) does not recognise the restructuring provision. The change is recognised in retained earnings (IFRS 1.C4(c)(iii))
- (b) does not recognise the intangible asset. The item is reclassified to goodwill (IFRS 1.C4(c)(i))
- (c) tests the goodwill for impairment under IAS 36 (IFRS 1.C4(g)(ii)).

Appendix II.7.2 includes further discussion of the treatment of intangible assets acquired in a past business combination.

2.1.5.2 Items that were not recognised under previous GAAP

The requirements for assets and liabilities not recognised under previous GAAP are slightly different than those described in paragraph 2.1.5.1. IFRS 1 generally requires assets and liabilities to be recognised in the opening statement of financial position if their recognition is required by IFRSs. However, assets and liabilities acquired or assumed in a past business combination that were not recognised in the acquirer's consolidated financial statements under previous GAAP are recognised in the opening statement of financial position only if they qualify for recognition in the separate statement of financial position of the acquiree (IFRS 1.C4(b)(ii)).

If the application of this requirement results in the recognition of assets and liabilities that were not recognised under previous GAAP, a question arises as to their deemed cost under IFRSs. The assets and liabilities do not have a deemed cost of zero in the opening statement of financial position (IFRS 1.C4(f)). Instead, IFRS 1 explains that they are recognised on the basis that IFRSs would require in the separate statement of financial position of the acquiree.

An example of an adjustment that may be required, and to which IFRS 1.C4(f) is relevant, involves leasing. Under previous GAAP an asset and liability under a finance lease acquired in a past business combination may not have been recognised, perhaps because the lease was classified as an operating lease. The first-time adopter of IFRSs must nonetheless recognise the asset and liability as IAS 17 'Leases' would require the acquiree to do so in its IFRS separate statement of financial position (IFRS 1.C4(f) and IFRS 1.IG Example 7).

This is illustrated in example C.3.

Example C.3: Items recognised on the basis of the acquiree's separate financial statements

Background

Entity A is a first-time adopter and its first IFRS reporting period ends on 31 December 2012. Its date of transition to IFRSs is 1 January 2011.

Entity A acquired subsidiary M before 1 January 2011. Under its previous GAAP Entity A did not capitalise subsidiary M's finance leases. In accordance with IFRSs, the subsidiary M is required to recognise the finance leases in its separate financial statements. At 1 January 2011, the carrying amount of finance leased assets of Entity M is CU 2,000. The carrying amount of finance lease obligations is CU 2,200.

Application of requirements

In its consolidated opening IFRS statement of financial position, entity A recognises finance lease obligations of CU 2,200 and finance leased assets of CU 2,000. Entity A charges CU 200 to retained earnings (IFRS 1.C4(f)).

The difference between the approach for items recognised under previous GAAP (see paragraph 2.1.5.1) and items not recognised is best illustrated by reference to contingent liabilities and intangible assets. Applying IFRS 3 to the past business combination might have resulted in the recognition of a contingent liability of the acquiree. Moreover, internally generated intangible assets are recognised to a greater extent when applying IFRS 3. However, IFRS 1.C4(b)(ii) only permits recognition based on IFRSs as it applies to the separate financial statements of the acquiree.

The effects are illustrated in the following example:

Example C.4: Items recognised on the basis of the acquiree's separate financial statements

Background

Entity A is a first-time adopter and its first IFRS reporting period ends on 31 December 2012. Its date of transition to IFRSs is 1 January 2011. Entity A acquired subsidiary M before 1 January 2011.

Under previous GAAP, entity A did not recognise in its consolidated financial statements:

- (a) a contingent liability, and
- (b) internally generated trademarks.

These items were subsumed within goodwill under previous GAAP.

Application of requirements

Items not recognised under previous GAAP are recognised in the opening statement of financial position only if they would qualify for recognition in the separate statement of financial position of the acquiree (IFRS 1.C4(b)(ii)). This is applied as follows for the items in question:

- (a) Contingent liabilities are not recognised in accordance with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'. Accordingly, the contingent liability is not recognised in the opening statement of financial position
- (b) Internally generated trademarks cannot be recognised in accordance with IAS 38 'Intangible Assets'. Accordingly, the first-time adopter does not recognise this item in the opening statement of financial position.

The practical implications of IFRS 1.C4(b)(ii) for internally generated intangible assets are discussed further in Appendix II.7.2.

The changes resulting from the recognition of assets that were not recognised under previous GAAP are addressed in IFRS 1.C4(b). The first-time adopter should recognise the resulting changes by adjusting retained earnings or, if appropriate, another category of equity (IFRS 1.C4(b)(ii)). However, when a change results from the recognition of an intangible asset that was previously subsumed within goodwill, the carrying value of goodwill is reduced accordingly (IFRS 1.C4(g)(i)).

2.1.6 Measurement

If IFRS 3 is not applied the normal measurement requirements of IFRSs generally apply to the acquired assets and liabilities assumed (to the extent recognised). The first-time adopter therefore adjusts the carrying amounts of assets and liabilities in the opening statement of financial position. To comply with IAS 12 'Income Taxes' it also adjusts deferred tax as a result of the re-measurement of assets and liabilities. Non-controlling interests are also restated in the consolidated financial statements (IFRS 1.C4(k)).

A first-time adopter need not apply IAS 21 'The Effects of Changes in Foreign Exchange Rates' (IAS 21) retrospectively to fair value adjustments and goodwill arising in past business combinations (IFRS 1.C2). These are treated either as items measured in the acquiring entity's functional currency or as a non-monetary item reported at the exchange rate used under previous GAAP. Goodwill is only restated if required by IFRS 1.C4(g). If a first-time adopter does elect to apply IAS 21 retrospectively it must be applied consistently with IFRS 1.C1, ie it must be applied for either all past business combinations or all business combinations after the restated business combination (IFRS 1.C3).

For assets and liabilities that are not measured based on original cost under normal IFRSs (for example, those measured at fair value) a first-time adopter applies the measurement basis required by IFRSs in its opening statement of financial position. The resulting change is recognised by adjusting retained earnings or another appropriate category of equity (for example, in the case of available-for-sale financial assets), IFRS 1.C4(d).

For assets and liabilities where IFRSs subsequently require a cost-based measurement, the carrying amounts immediately after the business combination under previous GAAP become deemed cost under IFRSs at that date. The deemed cost is the basis for depreciation or amortisation from the acquisition date (IFRS 1.C4(e)). This exemption is important in practice as it means that a fair value adjustment under previous GAAP does not have to be restated under IFRSs. This amount is the basis for accounting under IFRSs going forward.

Under previous GAAP, a first-time adopter may not have consolidated a subsidiary that should be consolidated under IFRSs and which it acquired in a past business combination. At the date of transition the first-time adopter in its opening consolidated statement of financial position:³

- consolidates the subsidiary and restates the carrying amount of assets and liabilities of the subsidiary to the amounts required under IFRSs for the subsidiary's (acquiree's) statement of financial position

³ IFRS 1.IG Example 6 provides an example of such a situation.

- recognises and measures goodwill as the parent's interest in the adjusted carrying amounts of the net assets of the subsidiary less the cost of the subsidiary in the parent's separate financial statements. This amount represents the deemed cost of goodwill at the date of transition (IFRS 1.C4(j))
- tests goodwill for impairment at the date of transition
- restates non-controlling interests based on the net assets of the subsidiary, if applicable.

After these adjustments, the consolidated statement of financial position at the date of transition includes the net assets of the subsidiary, and the restated amount of goodwill and non-controlling interests. Under previous GAAP goodwill would not have been recognised as the subsidiary was not consolidated.

2.2 Goodwill

The previous paragraphs explain the various adjustments for assets acquired and liabilities assumed in a past business combination to which IFRS 3 is not applied. In the case of goodwill, IFRS 1.C includes specific rules. IFRS 1.C4(g) requires that the carrying amount of goodwill in the opening statement of financial position is its carrying amount under previous GAAP at the date of transition to IFRSs, after the following adjustments:

- when a first-time adopter derecognises an intangible asset acquired in a past business combination that does not qualify for recognition under IAS 38 'Intangible Assets' (IAS 38) it reclassifies this amount to goodwill, including the related deferred tax or non-controlling interests, if any (see IFRS 1.C4(c)(i) and IFRS 1.IG Example 4)⁴
- if a first-time adopter recognises an intangible asset that was subsumed in goodwill under previous GAAP because previous GAAP did not permit recognition of such an intangible asset, the carrying amount of goodwill is decreased accordingly (and deferred tax and non-controlling interests adjusted, if applicable) (see IFRS 1.C4(f) and IFRS 1.C4(g)(i))⁵
- regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter applies IAS 36 'Impairment of Assets' in testing the goodwill for impairment at the date of transition to IFRSs. Any resulting impairment loss is recognised in retained earnings (or, if so required by IAS 36, in revaluation surplus). The impairment test is based on conditions at the date of transition to IFRSs (IFRS 1.C4(g)(ii)).

No other adjustments are made to the previous GAAP carrying amount of goodwill at the date of transition. For example, any amortisation of goodwill recorded under previous GAAP is not reversed (IFRS 1.C4(h)(ii)). The same applies to previous GAAP impairment losses.

Contingent consideration

Contingent consideration contracts are within the scope of IAS 32 and IAS 39. If a first-time adopter has an 'open' contingent consideration contract from a past business combination (to which IFRS 3 is not applied), it recognises a liability at its date of transition if the obligation meets IAS 32's definition of a financial liability. The liability is measured in accordance with IAS 39. If the obligation meets IAS 32's definition of an equity instrument there is no requirement to restate the amount recognised under previous GAAP (even if the local GAAP amount is zero). Goodwill is not adjusted.

⁴ Does not apply if goodwill was previously deducted from equity under previous GAAP, rather the elimination of the intangible asset decreases retained earnings (see IFRS 1.IG Example 5).

⁵ If goodwill under previous GAAP was recognised as a deduction from equity, then the adjustment shall be made to retained earnings.

If the first-time adopter under previous GAAP recognised goodwill as a deduction from equity, IFRS1.C4(i) applies. The above rules would not apply because no goodwill was recognised under previous GAAP. The standard prescribes that goodwill shall not be reclassified from equity at the date of transition and that goodwill shall not be reclassified to profit or loss on disposal or impairment of the investment in the subsidiary. Adjustments resulting from a subsequent resolution of contingencies affecting the purchase consideration shall be recognised in retained earnings.⁶ Where the first-time adopter records adjustments to intangible assets, the adjustment shall likewise be made to retained earnings (IFRS 1.IG Example 5).

2.3 Deemed cost

2.3.1 Property, plant and equipment

IAS 16 'Property, Plant and Equipment' (IAS 16) requires the entity to determine the original cost of the asset in accordance with the requirements of that standard. This is required even if the first-time adopter uses IAS 16's revaluation model. Although this might seem straightforward, IAS 16 includes quite detailed rules on the elements of cost. As a result some first-time adopters may not have access to all the information necessary to determine cost as specified. Determining previous amounts of accumulated depreciation on an IAS 16 basis might also be challenging. Moreover, an original cost-based carrying value may not provide the most relevant information. For all these reasons, IFRS 1 permits a first-time adopter to report items of property, plant and equipment in its opening statement of financial position at a 'deemed cost' as an alternative to an 'IAS 16 cost'.

IFRS 1's deemed cost exemption may be elected for a single item of property, plant and equipment – it need not be applied to an entire class of assets. A first-time adopter may elect to use one of the following amounts as the deemed cost of an item of property, plant and equipment:

- fair value at the date of transition (IFRS 1.D5)
- the amount determined under a previous GAAP revaluation at, or before, the date of transition if the revaluation was broadly comparable to either fair value or cost or depreciated cost under IFRSs (adjusted to reflect, for example, changes in a general or specific price index). This amount is the deemed cost at the date of revaluation (IFRS 1.D6)
- a deemed cost under previous GAAP established by measuring some or all assets and liabilities at fair value at one particular date because of an event such as a privatisation or initial public offering (IFRS 1.D8) – see paragraph 2.3.3 below
- for the special case of entities with operations subject to rate regulation, the carrying amount determined under the entity's previous GAAP (IFRS 1.D8B) – see paragraph 2.3.4 below.

At and after the date of transition, the accounting for property, plant and equipment depends on whether the first-time adopter adopts IAS 16's cost model or its revaluation model.

At the date of transition under the cost model, depreciation (determined in accordance with IAS 16) is based on the deemed cost starting from the date for which the first-time adopter established the deemed cost (IFRS 1.IG9). If necessary the first-time adopter adjusts accumulated depreciation under previous GAAP (IFRS 1.IG7). If deemed cost was established at the date of transition (for example the fair value at that date), then the item is measured at that amount at the date of transition. The adjustment to previous GAAP should be made to retained earnings (not revaluation reserve). After the date of transition the IAS 16 cost model continues to be applied based on the transition date carrying values.

⁶ Refer to IFRS 1.IG Example 5 as an example of the accounting for such a business combination.

If the first-time adopter elects to use IAS 16's revaluation model, that model must be applied to an entire class (or classes) of assets. The class of assets is measured at fair value less subsequent depreciation and impairment. The carrying value at the date of transition shall not be materially different from fair value at that date. If this is the case a revaluation is required (IAS 16.31). The first-time adopter includes within equity a revaluation surplus at the date of transition, which is measured as the difference between the carrying amount at the date of transition less cost or deemed cost (IFRS 1.IG10). Accordingly, the deemed cost elections are still relevant, but only as a starting point for applying the revaluation model. If deemed cost is determined as fair value at the date of transition, the revaluation reserve within equity is nil. To illustrate this, consider the following example:

Example C.5: Revaluation model – fair value as deemed cost

Entity A is transitioning to IFRSs and adopts IAS 16's revaluation model as its accounting policy for its own-use land. The date of transition is 1 January 2011. Under previous GAAP entity A used a similar principle for its land and fair value of the land was measured at 31 December 2010. Entity A elects to use the fair value at this date as deemed cost at the date of transition. In the opening statement of financial position the land is measured at the fair value, which in this case equals deemed cost. Therefore, no revaluation reserve is recognised within equity. Entity A also gives the disclosures required by IFRS 1.30.

2.3.2 Investment property and intangible assets

The elections to use fair value or revaluation as deemed cost are also available for individual items of:

- investment property, where the first-time adopter uses the cost model in IAS 40 'Investment Property' (IAS 40) and
- intangible assets that qualify for recognition in accordance with IAS 38 (including reliable measurement of original cost) and satisfy the criteria in IAS 38 for revaluation (including the existence of an active market).⁷

A first-time adopter may not use these exemptions on any other assets or for liabilities (IFRS 1.D7).

For investment property, where the IAS 40 fair value model is applied, the first-time adopter measures all of its investment properties at fair value at the date of transition. In this case deemed cost elections in IFRS 1 do not apply. If the IAS 40 cost model is applied, the entity uses it for all of its investment properties (IAS 40.56). In this case the first-time adopter can elect to use fair value or revaluation as deemed cost (IFRS 1.IG61 – 62). Subsequent depreciation is recognised in accordance with IAS 16.

If, and only if, an intangible asset meets both the recognition criteria in IAS 38 (including reliable measurement of original cost) and the criteria in IAS 38 for revaluation (including the existence of an active market), a first-time adopter may elect to use either fair value or revaluation as deemed cost. These criteria are strict and have the effect that the deemed cost elections will not be available for most intangible assets. When available, the deemed cost elections apply whether or not the revaluation method in IAS 38 is applied (see also IFRS 1.IG50 – 51).

In the special case of entities with operations subject to rate regulation, an election to use the carrying amount determined under the entity's previous GAAP as deemed cost is also available for intangible assets (see paragraph 2.3.4 below).

To illustrate the deemed cost exemption, consider these examples:

⁷ This exemption is rarely applied in practice.

Example C.6: Deemed cost of property, plant & equipment

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. Its date of transition to IFRSs is 1 January 2011.

Entity A operates a fleet of ships. The ships' engines are replaced every 10 years and, under previous GAAP, the cost of renewal is charged to the profit or loss statement at the time of replacement. The ships' original cost is depreciated over their estimated overall useful life of 30 years.

Entity A's accounting records do not contain the information needed to identify the cost of engine replacements that would have met the grounds for capitalisation under IAS 16 before transition to IFRSs.

Application of requirements

IAS 16 requires that, where an asset has separately identifiable components that have a shorter useful life than the overall asset and replacement of the component represents a significant cost in comparison to the asset as a whole, the identifiable component should be accounted for as a separate asset for the purpose of calculating depreciation. If entity A does not use the deemed cost exemption under IFRS 1 for the ships, the component approach required by IAS 16 should be applied retrospectively. However, in this case, it is not practicable because the information required is not available. Therefore, entity A should apply the fair value as deemed cost exemption to restate the ships to fair value at 1 January 2011. The fair value should be analysed into the different significant components (eg engines, hulls and other fit-out costs). The component approach should then be applied prospectively from 1 January 2011 with each component being depreciated over its remaining useful life.

Example C.7: Deemed cost of lease premium

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. Its date of transition to IFRSs is 1 January 2011.

Entity A paid a CU 1m leasehold premium for a 40-year lease on a property in January 2009. On this date, entity A determined that the relative fair values of the initial leasehold interests were CU 800,000 for the building and CU 200,000 for the land.

Under previous GAAP, this premium was capitalised as a single property asset held under a finance lease and depreciated on a straight-line basis. The single property asset was revalued up to CU 1.8m on 31 December 2010 and a revaluation surplus of CU 850,000 recognised in equity (revalued amount of 1.8m less depreciated carrying value of 950,000). The amounts recognised in its previous GAAP financial statements at 31 December 2010 in relation to the building and the land are determined to be CU 1,440,000 and CU 360,000 respectively, based on the initial split of fair values.

At 1 January 2011, entity A determines that the buildings element is a finance lease under IAS 17 'Leases' and that the land is held under an operating lease. Entity A wishes to take advantage of the fair value as deemed cost exemption in IFRS 1. Entity A proposes to split the CU 1.8m into two elements in its statement of financial position at transition: CU 1,440,000 relating to the building in property, plant and equipment and CU 360,000 relating to the land as a prepayment.

Application of requirements

The proposed treatment is not acceptable. Entity A is correct to split the leasehold interest into separate building and land elements under IAS 17. However, the fair value as deemed cost exemption in IFRS 1 is not available to prepayments.

The building asset may, therefore, be stated at its revalued amount of CU 1,440,000 and this can be used as its deemed cost going forward under IFRSs. The prepayment, however, must be restated to original cost (estimated at CU 200,000 less 2 years of amortisation, CU 10,000) and an adjustment is required on transition that will result in a debit of CU 170,000 to the revaluation reserve.

2.3.3 Event-driven fair value as deemed cost under IFRSs

Paragraph D8 of IFRS 1 states:

“A first-time adopter may have established a deemed cost in accordance with previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatisation or initial public offering.

- (a) If the measurement date is at or before the date of transition to IFRSs, the entity may use such event-driven fair value measurements as deemed cost for IFRSs at the date of that measurement.
- (b) If the measurement date is after the date of transition to IFRSs, but during the period covered by the first IFRS financial statements, the event-driven fair value measurements may be used as deemed cost when the event occurs. An entity shall recognise the resulting adjustments directly in retained earnings (or if appropriate, another category of equity) at the measurement date. At the date of transition to IFRSs, the entity shall either establish the deemed cost by applying the criteria in paragraphs D5 – D7 or measure assets and liabilities in accordance with the other requirements in this IFRS.”

The paragraph explains that event-driven fair value measurements can be used in general for all assets and liabilities as a substitute for cost (deemed cost). Unlike the exemptions in IFRS 1.D5 – 6, its use is not restricted solely to property, plant and equipment, intangible assets or investment property and in our view can be applied on an item-by-item basis. The application of the exemption depends on the date of the measurement as follows:

- if the measurement date is at or before the date of transition, the first-time adopter can use the event-driven fair value measurement under previous GAAP as a deemed cost under IFRSs at the date of the measurement. Subsequently, it should apply the requirements of the relevant IFRSs
- if the measurement date is after the date of transition but during the period covered by the first IFRS financial statements, the first-time adopter should determine at the date of transition a deemed cost by applying the requirements in IFRS 1.D5 – 7 or by applying the relevant IFRSs. After the date of transition, it then applies the requirement in the relevant IFRSs. The first-time adopter may then elect to use the event-driven fair value measurement as a deemed cost at the date of the measurement and recognise all the adjustments directly in equity as IFRS 1 adjustments.

To illustrate, consider these examples:

Example C.8: Event-driven fair value for an asset measured at cost model – the measurement date is on or before the date of transition

Entity A prepares its first IFRS financial statements in 2012. Its date of transition to IFRSs is 1 January 2011. As the result of privatisation, entity A has established an event-driven deemed cost under previous GAAP for an item of property, plant and equipment. The deemed cost was established at 1 January 2010. At 1 January 2011, entity A elects to use the ‘event-driven fair value’ exemption in IFRS 1.D8. Therefore the cost of the item under IFRSs is the deemed cost established under previous GAAP. If the item is measured at cost less accumulated depreciation and impairment under IFRSs, at the date of transition the entity measures the item at deemed cost at 1 January 2010 less subsequent depreciation until 1 January 2011.

Example C.8A: Event-driven fair value for an asset measured at cost model – the measurement date is after the date of transition

Entity A prepares its first IFRS financial statements in 2012. Its date of transition to IFRSs is 1 January 2011. Due to a regulatory requirement, entity A revalued all of its assets at 31 December 2011. Entity A elects to use the ‘event-driven fair value’ exemption in IFRS 1.D8 for its property, plant and equipment. It therefore:

- (a) at 1 January 2011 either determines a deemed cost according to IFRS 1 or applies IAS 16
- (b) from 1 January 2011 to 31 December 2011 applies IAS 16 on the basis of the amount determined in (a)
- (c) at 31 December 2011 uses the event-driven fair values as deemed cost and recognises all the adjustments directly in equity as an IFRS 1 adjustment
- (d) from 31 December 2011 applies IAS 16 prospectively.

2.3.4 Entities with operations subject to rate regulation

A first-time adopter with operations subject to rate regulation may use the carrying amount of the items of property, plant and equipment or intangible assets determined under the entity's previous GAAP (whether or not the carrying amount includes amounts that would qualify for capitalisation under IFRSs) as deemed cost at the date of transition to IFRSs. This applies on an item-by-item basis. Each item to which this exemption is applied is subject to impairment testing in accordance with IAS 36. For the purpose of this exemption:

"...operations are subject to rate regulation if they provide goods or services to customers at prices (ie rates) established by an authorised body empowered to establish rates that bind the customers and that are designed to recover the specific costs the entity incurs in providing the regulated goods or services and to earn a specified return." (IFRS 1.D8B)

2.3.5 Exploration, evaluation, development or production of oil and gas

A first-time adopter which has previously accounted for its exploration and development costs for oil and gas properties in the development or production phases in cost centres that include all properties in a large geographical area ('full cost accounting'), may elect to measure such assets on the date of transition on the following basis:

- exploration and evaluation assets: at the amount determined under the entity's previous GAAP. The first-time adopter is required to test these assets for impairment in accordance with IFRS 6 'Exploration for and Evaluation of Mineral Resources'
- assets in the development or production phases: at the amount determined for the cost centre under the entity's previous GAAP. The first-time adopter shall allocate this amount to the cost centre's underlying assets pro rata using reserve volumes or reserve values as of that date, and is required to test these assets for impairment in accordance with IAS 36 (IFRS 1.D8A).

The deemed cost should, if necessary, reflect any impairment recognised at the date of transition.

2.4 Employee benefits

Under the previous version of IAS 19 'Employee Benefits' (IAS 19), in accounting for defined benefit-type post-employment plans an entity was able to elect to use a 'corridor' approach. The corridor method resulted in some actuarial gains and losses not being recognised. For a first-time adopter, applying the corridor method retrospectively is challenging. IFRS 1.D10 therefore provides an exemption under which a first-time adopter may elect to recognise all cumulative actuarial gains and losses at the date of transition to IFRSs (and then apply the corridor method or another method prospectively after that date).

In June 2011 the IASB issued an amended version of IAS 19 (IAS 19R) that is effective for annual periods beginning on or after 1 January 2013 (earlier application is permitted). IAS 19R eliminates the corridor method and also deletes the exemption in IFRS 1.D10 for a first-time adopter that applies IAS 19R.

A first-time adopter whose first IFRS annual period begins before 1 January 2013 may elect to apply either IAS 19R or the previous version of IAS 19 in its first IFRS financial statements. If it applies the previous version it is able to use the exemption in IFRS 1.D10. However, it will then need to revise its accounting policy when preparing its financial statements for annual periods beginning on or after 1 January 2013.

To illustrate consider the following example:

Example C.9: Employee benefits

Entity A will prepare its first IFRS financial statements for the year ending 31 December 2012. Its date of transition to IFRSs is 1 January 2011. Entity A has a defined benefit plan that provides an annual pension of 2% of final salary for each year of service. Entity A has the following options in its first IFRS financial statements:

- (a) early adopt IAS 19R and apply it retrospectively
- (b) apply the previous version of IAS 19 retrospectively, without applying IFRS 1.D10. Entity A can then apply the corridor method in accordance with IAS 19, including its accounting policy for deferral of actuarial gains or losses, at 1 January 2011
- (c) apply the previous version of IAS 19 retrospectively, and also apply IFRS 1.D10. Entity A then recognises all cumulative actuarial gains and losses from all of its plans at 1 January 2011 but can apply the corridor method in the two years ending 31 December 2012

If entity A takes option (b) or (c) it will then need to revise its accounting policy in its 2013 financial statements when it is required to apply IAS 19R. Generally, IAS 19R's transition provisions require retrospective application.

2.5 Cumulative translation differences

IAS 21 'The Effects of Changes in Foreign Exchange Rates' requires translation differences arising on translation of foreign operations to be accumulated in a separate reserve within equity. Applying these requirements retrospectively would require an entity to determine the cumulative translation differences at the date of transition and separately classify these within equity. A first-time adopter has the option not to comply with this requirement at the date of transition (IFRS 1.D13).

If this option is chosen, the first-time adopter resets cumulative translation differences to zero at the date of transition. On subsequent disposal of foreign operations, the calculation of gain or loss includes only translation differences arising after the date of transition.

This option is useful in practice and has been taken up by many first-time adopters. Often entities will not have calculated translation differences under previous GAAP. Furthermore, full retrospective application would require a first-time adopter to prepare (or reconstruct) IFRS-based financial statements for foreign operations for periods before transition to IFRSs. In many cases this would be costly or impracticable.

2.6 Compound financial instruments

The issuer of a so-called compound financial instrument is required at inception to allocate the instrument into a liability and equity component in accordance with IAS 32 'Financial Instruments: Presentation' (IAS 32). IFRS 1.D18 exempts the first-time adopter from separating the equity and liability components at the date of transition if the liability is no longer outstanding at that date.

This exemption is useful because retrospective application would involve separating two portions of equity (given that the liability component no longer exists). The cumulative interest accreted on the liability component would be included in retained earnings, whereas the equity component would be recognised in another component of equity.

Where the liability component is still outstanding at the date of transition, the first-time adopter needs to separate the compound financial instrument retrospectively as if it had always been measured under IFRSs. This means applying the requirements of IAS 32 based on circumstances existing when the instrument was issued (IFRS 1.IG36).

2.7 Assets and liabilities of subsidiaries, associates and joint ventures

Entities in the same group may adopt IFRSs at different dates. When entities within a group adopt IFRSs at different dates, each entity has its own date of transition and applies IFRS 1 accordingly. The exemptions in IFRS 1.D16 – 17 deal with first-time adoption in these situations. Three scenarios are addressed: (i) a subsidiary becomes a first-time adopter later than its parent, (ii) a parent becomes a first-time adopter later than its subsidiary, and (iii) a parent becomes a first-time adopter for its separate financial statements at an earlier or later date than for its consolidated financial statements.

These requirements are frequently relevant in practice – reflecting the fact that many jurisdictions adopt IFRSs at different times for consolidated, separate and individual financial statements. For example, a parent entity in a country that is adopting IFRSs may have a subsidiary or associate in a country where the financial statements have been prepared under IFRSs in previous years.

2.7.1 Subsidiary adopts IFRSs later than its parent

A subsidiary may become a first-time adopter later than its parent due to local law or regulation, or because the entity voluntarily applies IFRSs at a different date. IFRS 1.D16 states that the subsidiary has two options for measuring assets and liabilities at the date of transition in its first IFRS financial statements. It measures its assets and liabilities at either:

- the carrying amounts 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 (IFRS 1.D16(a))
or
- the carrying amounts required by IFRSs based on the subsidiary's own date of transition (IFRS 1.D16(b)).

The first option involves the subsidiary using the same numbers it produced for the parent's consolidated financial statements based on the parent's date of transition. This implies using all of the applicable IFRS 1 elections made by the parent on first-time adoption. For example, if the parent has used a deemed cost exemption for some of a subsidiary's assets or liabilities then the subsidiary is also bound by this choice. The option is useful as the group can maintain a single set of accounting records for the subsidiary and reduce incremental work when the subsidiary adopts IFRSs.

The second option involves adopting IFRSs independently. The subsidiary makes its own IFRS 1 elections and is not bound by those made by its parent.

The first option does not mean that the subsidiary's financial statements are entirely consistent with the amounts included in the consolidated financial statements. Adjustments are made for consolidation purposes and for the parent's accounting for the business combination in which the subsidiary was acquired (if applicable). For example, adjustments might be required to reinstate intra-group payables and receivables that are eliminated in the consolidated financial statements. We also consider that the subsidiary is permitted to adjust the amounts in the consolidated financial statements to reflect the subsidiary's accounting policies if these differ from those of the parent. In other words, the subsidiary is not bound by the group's accounting policy choices for the purposes of its individual financial statements. For example, the subsidiary may elect to present investment properties at fair value even though the cost model is used in the consolidated financial statements.

The options are also available for an associate or a joint venture that moves to IFRSs at a later date than the investor that has significant influence or joint control over it.

To illustrate IFRS 1.D16, consider the example below (see also IFRS 1.IG Example 8):

Example C.10: Subsidiary adopts IFRSs later than its parent

A parent entity (P) presents its first IFRS consolidated financial statements in 2009. A foreign subsidiary (S) is not permitted under local law to present IFRS financial statements until 2012. However, a reporting package under IFRSs is prepared for the purpose of the consolidated financial statements of parent entity P.

Application of paragraph D16(a)

Subsidiary S applies paragraph D16(a), ie it chooses to use the carrying amounts that would be included in P's consolidated financial statements. Its date of transition is 1 January 2011. At 1 January 2011, S's assets and liabilities in its opening statement of financial position are the same as in P's consolidated financial statements, adjusted for consolidation adjustments and the effects of the business combination in which P acquired S. These figures are based on P's date of transition to IFRSs and are acceptable because they already comply with IFRSs. S may however adopt its own IFRS accounting policies, in which case it changes the amounts to conform with those policies as necessary.

Application of paragraph D16(b)

Alternatively, subsidiary S could apply paragraph D16(b). Under this approach, at the date of transition (1 January 2011), S measures all of its assets and liabilities based on its own date of transition. S makes its own IFRS 1 elections which may differ from those made by P. S continues to prepare a reporting package to P, however, these numbers are based on P's date of transition and they are not changed due to the fact that S becomes a first-time adopter later than its parent. In effect, S prepares two sets of financial statements.

2.7.2 Parent adopts IFRSs in its consolidated financial statements later than its subsidiary

In the reverse situation, where the group moves to IFRSs at a later date than its subsidiary (or associate or joint venture), the group shall in its consolidated financial statements:

"(...) measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary (...)" (IFRS 1.D17)

The principle is that once a part of the group has moved to IFRSs, then the parent cannot in its consolidated financial statements elect to change amounts that already comply with IFRSs. These amounts are based on the subsidiary's (or associate's or joint venture's) date of transition. The applicable amounts are not changed solely by the fact that the parent becomes a first-time adopter at a later date (IFRS 1.IG Example 9).

The rules are not optional

The rules are not in fact an optional exemption as IFRS 1.D1 seems to imply. The parent must use the subsidiary's amounts, except for the adjustments required by IFRS 1.D17. The parent is, however, still required to apply Appendix C of IFRS 1 to assets and liabilities acquired in a business combination.

The parent adjusts the subsidiary's amounts in its consolidated financial statements for consolidation adjustments such as elimination of intra-group balances. We believe that the parent is also permitted to adjust the subsidiary's amounts to conform with its own accounting policy choices. Indeed the parent is obliged to use uniform accounting policies in its consolidated financial statements; this necessitates making adjustments if different group entities have adopted different policies in their individual financial statements.

The effect of IFRS 1.D17 is that the parent entity's selection of IFRS 1 exemptions is restricted. The parent may not make elections which would restate the subsidiary's assets or liabilities. This may significantly limit the exemptions available. For example, the parent cannot elect to use the 'fair value or revaluation as deemed cost' exemption for a specific asset of a subsidiary that has already adopted IFRSs if that subsidiary measures the asset at its depreciated original cost.

In general, the IFRS 1 elections made by one subsidiary do not restrict the parent's choices in relation to assets and liabilities of other group entities that have not adopted IFRSs. Moreover, some of the subsidiaries' past IFRS 1 elections may not affect the measurement of its assets or liabilities (eg resetting cumulative translation differences).

Another complication arises for elections which the parent is obliged to make consistently for all affected items. For example, the IFRS 1 exemption for actuarial gains and losses must be used on all defined benefit plans in the group (IFRS 1.D10). If the parent has two subsidiaries with defined benefit plans, and only one used this election on adopting IFRSs, it would seem that a conflict arises. In our view, an accounting policy choice must then be made as to which IFRS 1 rule takes precedence.

2.7.3 Interaction with past business combination requirements

IFRS 1.IG30 states that IFRS 1.D16 – 17 do not override the requirements in IFRS 1.C for past business combinations. The implications of this statement depend on whether the parent elects to apply IFRS 3 to the past business combination, or follow the more common 'limited restatement' route in IFRS 1.C. The interaction between IFRS 1.D17 and IFRS 1.C is potentially complex and is not entirely clear.

If the parent does restate the business combination in accordance with IFRS 3, we believe that IFRS 1.D17 becomes irrelevant if the subsidiary adopted IFRSs before the acquisition date. The IFRS 3 adjustments made by the parent override the earlier IFRS 1 elections made by the subsidiary. If the subsidiary's date of transition is after the acquisition date, IFRS 1.IG30 suggests that IFRS 1.D17 applies only to its assets and liabilities arising after the acquisition date. Assets and liabilities that existed at the acquisition date are measured based on the requirements of IFRS 3.

If the parent does not restate the business combination, IFRS 1.D17 is applied only to assets and liabilities arising after the date of the combination. For assets and liabilities acquired in the business combination and still held, IFRS 1.C4(e) establishes that the previous GAAP carrying amount immediately after the business combination is deemed cost for IFRS purposes. It therefore seems that IFRS 1.D17 does not apply to the subsidiary's assets and liabilities acquired or assumed in the business combination, as to apply IFRS 1.D17 might result in a conflicting deemed cost (eg a subsequent revaluation).

When IFRS 3 is not applied, it is also clear that goodwill should be restated as required by IFRS 1.C4(g) and tested for impairment at the date of transition. Goodwill may be restated because the group under its previous GAAP has recognised intangible assets that do not qualify for recognition under IFRSs or because an intangible asset was subsumed within goodwill under previous GAAP. The parent does not adjust goodwill in relation to any intangible assets of the subsidiary that were acquired or developed after the acquisition date.

To illustrate, consider the following example (see also IFRS 1.IG Example 9):

Example C.11: Group adopts IFRSs later than its subsidiary

Parent (P) moves to IFRSs in 2012. Its date of transition is 1 January 2011. Previously P has prepared consolidated financial statements under local GAAP. Its foreign subsidiary (S) has prepared IFRS financial statements since 2009. For consolidation purposes these financial statements have been adjusted for the purpose of P's local GAAP consolidated financial statements.

In the opening (consolidated) statement of financial position at 1 January 2011 P uses the carrying amounts of subsidiary S's assets and liabilities in S's financial statements at that date, adjusted for consolidation procedures and the effects of the business combination in which P acquires S.

Parent P is still required to apply IFRS 1 Appendix C (if it does not restate past business combinations) to assets acquired and liabilities assumed in a past business combination. Assume P recognised goodwill under previous GAAP of CU 50. Parent P carries out an impairment test and determines that there is no impairment. It also establishes that no restatement to goodwill is required because of intangible assets that existed in the subsidiary at acquisition date. Accordingly, a goodwill amount of CU 50 is recognised at P's date of transition to IFRSs.

2.7.4 Separate financial statements of parent

If a parent becomes a first-time adopter in its separate financial statements at an earlier or later date than for its consolidated financial statements, it measures its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments (IFRS 1.D17). This treatment is compulsory.

Accordingly:

- if the parent is a first-time adopter in its separate financial statements before adopting IFRSs in its consolidated financial statements, the parent uses the same amounts in its consolidated statements as it did in its separate financial statements (also adjusted for consolidation entries)
- in the opposite situation the separate financial statements are based on the amounts in the consolidated financial statements (again after adjusting for consolidation entries).

The effect in either case is to restrict the IFRS 1 elections available in the later set of financial statements.

2.8 Designation of previously recognised financial instruments

In accordance with IAS 39 'Financial Instruments: Recognition and Measurement' (IAS 39) an entity is permitted to designate a financial asset upon initial recognition as available-for-sale or at fair value through profit or loss in specified circumstances. A financial liability can, likewise, be designated at fair value through profit or loss upon initial recognition if specified conditions are met. In IAS 39 itself, these optional designations are usually available only on initial recognition of the instrument. The exemption in IFRS 1.D19 allows a first-time adopter to designate eligible financial assets as available-for-sale at the date of transition. Similarly, financial assets and financial liabilities can be designated at fair value through profit or loss provided the applicable IAS 39 conditions are met at the date of transition.⁸ If the first-time adopter applies these rules it makes the note disclosures in accordance with IFRS 1.29 (see section D).

2.9 Share-based payment transactions

IFRS 2 'Share-based Payment' (IFRS 2) addresses the accounting for transactions in which an entity uses equity instruments to purchase goods and services (including employee services). IFRS 1 includes options that limit the extent to which a first-time adopter is required to apply IFRS 2 to certain share-based payment awards granted in previous periods. The various options, which are similar to those available to an ongoing IFRS entity in IFRS 2 itself, are described in this section.

For all awards granted after the date of transition, the first-time adopter is required to apply IFRS 2 in full.

⁸ For entities presenting their first IFRS financial statements for annual periods beginning before 1 September 2006, certain transitional provisions applied for designating financial assets and liabilities at fair value through profit or loss. However, we anticipate that these rules are not relevant for current first-time adopters and are therefore not described here.

2.9.1 Equity-settled share-based payment transactions

IFRS 1 includes exemptions from applying IFRS 2 to 'old' share-based payments. IFRS 1 also states that the first-time adopter is nonetheless encouraged to apply IFRS 2 to all share-based payments under certain conditions. However, in our experience IFRS 2 has rarely been applied to awards to which an exemption applies. The exemptions are available for equity instruments:

- granted on or before 7 November 2002
- granted after 7 November 2002 but vested before the later of (a) the date of transition, or (b) 1 January 2005. In most cases, the relevant date for current first-time adopters will be the date of transition (IFRS 1.D2).

A first-time adopter is permitted to apply IFRS 2 to such equity instruments only if it has previously disclosed the fair value of the instruments at the IFRS 2 measurement date (generally the grant date).

The exemptions mean that a first-time adopter is not required to apply IFRS 2 to any equity instruments that vested before the date of transition. The IASB noted that this is sensible because no expense would be presented in the first IFRS financial statements even if IFRS 2 was to be applied. In addition, IFRS 2 need not be applied to equity instruments granted on or before 7 November 2002 even if they vest after the date of transition. This date has not been extended since the original version of IFRS 1 and the exemption is now unlikely to apply given the passage of time. If IFRS 2 is not applied to equity instruments, a first-time adopter nevertheless discloses information on arrangements that exist during the reporting period as required by IFRS 2.44 – 45. These disclosures can be extensive.

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 first-time adopter is not required to apply IFRS 2.26 – 29 if the modification occurred before the date of transition to IFRSs.

Example C.12: Application of IFRS 2 on first-time adoption

A first-time adopter prepares its first IFRS financial statements for the period ending 31 December 2012. The date of transition to IFRSs is 1 January 2011. The first-time adopter need not apply IFRS 2 for equity instruments that vested before 1 January 2011.

In addition, the first-time adopter has issued equity instruments before 7 November 2002 that have not yet vested. The first-time adopter is not required to apply IFRS 2 to those equity instruments. The first-time adopter is only allowed to apply IFRS 2 to these equity instruments if it has met the requirements for previous public disclosure of fair value (see below).

As noted, applying IFRS 2 retrospectively to some previous awards of equity instruments is conditional on having disclosed publicly the fair value of the instruments determined at the IFRS 2 measurement date. In practice, this often prohibits application of IFRS 2 to past awards. IFRS 1 does not elaborate on 'disclosed publicly' and although disclosure in previous financial statements may not be the only way to meet the requirement, it is the most common and unambiguous method in practice.

2.9.2 Cash-settled share-based payment transactions

There are separate requirements for cash-settled transactions. IFRS 1.D3 states that a first-time adopter is not required to apply IFRS 2 (but is encouraged to) in the following situations:

- liabilities arising from share-based payment transactions that were settled before the date of transition to IFRSs and
- liabilities that were settled before 1 January 2005.

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.

2.10 Insurance contracts

In accordance with IFRS 1.D4, a first-time adopter may apply the transitional provisions of IFRS 4 'Insurance Contracts' (see IFRS 4.40).

The transitional provisions in IFRS 4 give various exemptions from retrospective application. These exemptions, which relate to disclosure of comparative information, are mainly applicable only to annual periods beginning before 1 January 2005 and are therefore now of limited relevance. The transitional provisions also contain certain reliefs from disclosure of claims development history occurring more than five years from the end of the year in which IFRS 4 is first applied (IFRS 4.44). This relief remains relevant.

Adoption of amendments regarding financial guarantee contracts in IAS 39 and IFRS 4, effective from 1 January 2006, are subject to special provisions.

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

IFRIC 1 'Changes in Existing Decommissioning, Restoration and Similar Liabilities' (IFRIC 1) considers the accounting for changes in the obligations to dismantle, remove and restore items of property, plant and equipment. The cost of property, plant and equipment includes the initial estimate of these costs. IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' (IAS 37) contains guidance on how to measure the related liabilities. In general, IFRIC 1 requires changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates. The adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life.

IFRS 1 recognises the difficulty of constructing an historical record of these adjustments in previous years. IFRS 1 therefore includes an exemption to retrospective application of IFRIC 1. A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition. If this option is chosen, IFRS 1.D21 requires that the first-time adopter measures the liability at the date of transition in accordance with the requirements in IAS 37. Except as mentioned in paragraph 2.11.1 below, the first-time adopter includes in the depreciated cost of the asset an amount calculated by discounting the liability at the date of transition back to when the liability was first incurred (using its best estimate of the historical risk-adjusted discount rate that would have applied for that liability over the intervening period) and depreciating this adjustment from that date. IFRS 1.IG Example 201 and example C.13 below illustrate the effect of this exemption.

Example C.13: Decommissioning liability included in the cost of PPE

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. Its date of transition to IFRSs is 1 January 2011.

Entity A acquired a chemical plant on 1 January 2007 for CU 10,000. The estimated useful life is 50 years. Entity A has a decommissioning obligation related to that plant. At 1 January 2011, entity A estimates the obligation to be CU 1,200 and estimates that the appropriate risk-adjusted discount rate for the liability is 6%. Entity A's management judges that the appropriate discount rate has not changed since 1 January 2007.

Under its previous GAAP, entity A did not recognise a decommissioning liability. The local GAAP carrying amount of the plant at 1 January 2011 is CU 9,200. The fair value at that date is CU 9,400.

Application of requirements

Entity A has the following options:

- to adopt IAS 16, IAS 37 and IFRIC 1 retrospectively. It would then recognise an asset and a liability as if it had always applied these standards in its opening IFRS statement of financial position and throughout its first IFRS financial statements
- to apply IFRS 1.D21. Entity A should then (i) measure the liability in accordance with IAS 37 at 1 January 2011 – CU 82 (CU 1,200 discounted for 46 years at 6%); (ii) estimate the amount that would have been included in the cost of the asset when the liability first arose – CU 65 (CU 82 discounted for 4 years at 6%); and (iii) calculate the accumulated depreciation between these dates – CU 5 (CU 65 * (4/50))

Entity A then adjusts the carrying value of the asset and recognises the decommissioning liability. It needs to record the following entry at 1 January 2011:

	Debit CU	Credit CU
PPE	65	
Retained earnings (IFRS 1 transition)	22	
Accumulated depreciation		5
Decommissioning liability		82

(c) to apply IFRS 1.D5 and measure the asset using fair value as deemed cost (CU 9,400). A question then arises about whether to adjust the carrying value of the asset to include the decommissioning liability. In our view, entity A should avoid 'double counting'. This means that entity A should consider whether the fair value estimate has been reduced for the effect of the decommissioning obligations that a hypothetical buyer would assume. If so, the adjustment above should be recorded. Alternatively, if the fair value estimate is 'gross' (ie it assumes a sale in which the buyer does not assume the decommissioning obligation), it would be inappropriate to further increase the carrying value. In that case entity A records the following entry at 1 January 2011:

	Debit CU	Credit CU
Retained earnings (IFRS 1 transition)	82	
Decommissioning liability		82

2.11.1 Exploration, evaluation, development or production of oil and gas assets

A first time adopter that applies the deemed cost exemption related to oil and gas assets (see paragraph 2.3.5 above) must:

- measure decommissioning, restoration and similar liabilities as at the transition date in accordance with IAS 37 and
- recognise directly in retained earnings any difference between the amount measured under IAS 37 and the carrying amount of those liabilities under the entity's previous GAAP (IFRS 1.D21A).

2.12 Leases

A first-time adopter may apply the transitional provisions in IFRIC 4 'Determining whether an Arrangement Contains a Lease' (IFRIC 4). IFRIC 4 deals with arrangements that are not in the legal form of a lease but may include a lease based on IAS 17's definition (ie a right to use an asset in return for a payment or series of payments). IFRIC 4 generally requires an entity to determine whether an arrangement is, or contains, a lease at the inception of the contract. However, an ongoing IFRS entity is permitted to make the assessment at the beginning of the earliest comparative period presented when first applying IFRIC 4 (IFRIC 4.17).

A first-time adopter may determine whether an arrangement existing at the date of transition to IFRSs contains a lease on the basis of facts and circumstances existing at that date (IFRS 1.D9).

In addition, a first-time adopter does not need to reassess whether an arrangement contains a lease at the date of transition if, at a date other than required by IFRIC 4, it reached the same result under its previous GAAP as it would have from applying IAS 17 and IFRIC 4 (IFRS 1.D9A). If the first-time adopter does not apply IFRS 1.D9 or IFRS 1.D9A, it instead determines whether an arrangement existing at the date of transition to IFRSs contains a lease on the basis of facts and circumstances existing at the inception of the arrangement (IFRIC 4.10).

These exemptions are useful because it may be very difficult to assess older arrangements based on facts and circumstances at inception of the contract. It is important to note that all existing arrangements within the scope of IFRIC 4 need to be assessed on transition to IFRSs. The relief addresses only the date at which the facts and circumstances are assessed. If the arrangement is determined to contain a lease, the first-time adopter must measure the relevant amounts retrospectively. This applies equally to IFRIC 4 leases and free-standing leases. For example, if the lease is an operating lease the minimum lease payments are (in most cases) recognised on a straight-line basis over the entire lease term (not the remaining lease term after the date of transition). Some limited additional requirements are included in IFRS 1.IG14 – 16 (IFRS 1.IG Example 202). These requirements are described in Appendix II.

Example C.14: Arrangement contains a lease

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. Its date of transition to IFRSs is 1 January 2011. On 1 January 2009 entity A entered into an arrangement with a supplier to obtain a minimum quantity of electricity needed in its production process for a specified period of time.

Entity A assessed that the contract contained a lease in accordance with its previous GAAP. Entity A's previous GAAP includes requirements similar to IFRIC 4.

Application of paragraph D9

Entity A needs to determine on the basis of facts and circumstances at 1 January 2011 whether the arrangement contains a lease in accordance with IFRIC 4. If the arrangement contains a lease entity A needs to apply IAS 17 retrospectively.

Application of paragraph D9A

Entity A needs to determine whether:

- (a) its conclusion under previous GAAP is the same as it would have been under IFRIC 4 on 1 January 2009. If so, entity A does not need to reassess that determination. However, if the arrangement contains a lease entity A needs to apply IAS 17 retrospectively
- (b) its conclusion under previous GAAP is different than it would have been under IFRIC 4 on 1 January 2009.

If so, entity A either applies paragraph D9 (see above) or makes an IFRIC 4 assessment retrospectively (ie based on facts and circumstances at 1 January 2009).

2.13 Fair value measurement of financial assets or financial liabilities at initial recognition

IFRS 1.D20 contains an optional exemption from full retrospective application regarding the measurement of financial instruments at initial recognition. In summary, IAS 39 restricts an entity's ability to record a profit or loss when first recognising financial assets or liabilities to situations in which the fair value it ascribes to the instruments is based entirely on observable market data (IAS 39.AG76 – 76A).

IFRS 1 recognises that it may be difficult and expensive to determine retrospectively what is observable market data. Therefore, an exemption was granted to allow entities to apply the applicable IAS 39 requirements prospectively to transactions entered into on or after the date of transition.

2.14 Service concession arrangements

Service concession arrangements are dealt with in IFRIC 12 ‘Service Concession Arrangements’ (IFRIC 12). IFRIC 12 deals with contracts where a private sector entity participates in infrastructure for public sector services, such as financing, development, maintenance or operation of the infrastructure.

IFRS 1.D22 permits the transitional provisions of IFRIC 12 to be applied by a first-time adopter. These transitional provisions require retrospective application unless it is impracticable (IFRIC 12.29). Where it is impracticable, the first-time adopter shall:

- “(a) recognise financial assets and intangible assets that existed at the start of the earliest period presented;
- (b) use the previous carrying amounts of those financial and intangible assets (however previously classified) as their carrying amounts as at that date; and
- (c) test financial and intangible assets recognised at that date for impairment, unless this is not practicable, in which case the amounts shall be tested for impairment as at the start of the current period.” (IFRIC 12.30)

2.15 Borrowing costs

IAS 23 ‘Borrowing Costs’ (IAS 23) requires the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. Under IAS 23, an entity shall:

- begin to capitalise borrowing costs on the commencement date (see below) and
- cease to capitalise borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Commencement date under IAS 23

The commencement date for a particular asset is the date when the entity first meets all the following conditions:

- (a) incurs expenditures for the qualifying asset;
- (b) incurs borrowing costs; and
- (c) undertakes activities that are necessary to prepare the asset for its intended use or sale. (IAS 23.17)

IFRS 1.D23 allows a first-time adopter to apply the transitional provisions in IAS 23. This means a first-time adopter can:

- carry forward in the opening statement of financial position any borrowing costs that were capitalised before the date of transition in accordance with previous GAAP. A first-time adopter should account for borrowing costs incurred on or after the date of transition (including borrowing costs that relate to qualifying assets under construction at the date of the transition) in accordance with IAS 23 or
- apply the requirements of IAS 23 from a date earlier than the date of transition. If the first-time adopter elects to do so, it should apply IAS 23 for borrowing costs incurred on or after that date (including borrowing costs that relate to qualifying assets under construction at that date).

After the transition date, borrowing costs are accounted for in accordance with IAS 23.

To illustrate, consider the following examples:

Example C.15: Capitalisation of borrowing costs – inconsistent method

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2013. Its date of transition to IFRSs is 1 January 2012. Entity A is engaged in the construction of various qualifying assets.

Entity A's previous GAAP accounting policy was to capitalise borrowing costs as incurred. However, the previous GAAP capitalisation method is not fully consistent with the requirements of IAS 23. Entity A has the following options:

- (a) to adopt IAS 23 retrospectively. Entity A would then restate all qualifying assets as if it had always applied IAS 23 in its opening IFRS statement of financial position and throughout its first IFRS financial statements.
- (b) to apply IFRS 1.D23. The carrying amount for 1 January 2012 is not restated and is determined by the previous GAAP. Entity A capitalises borrowing costs incurred on or after 1 January 2012 (including borrowing costs that relate to qualifying assets under construction at 1 January 2012) in accordance with IAS 23.
- (c) to designate an earlier date. For example, entity A could designate 1 September 2010 as the date for adoption of IAS 23 (perhaps because a larger construction project commenced on that date). The carrying amount for 1 September 2010 is not restated and is determined by the previous GAAP. Entity A should capitalise borrowing costs incurred on or after 1 September 2010 (including borrowing costs that relate to qualifying assets under construction at 1 September 2010) in accordance with IAS 23.

Example C.15A: Expensing of borrowing costs

Entity B will prepare its first IFRS financial statements for the year ended 31 December 2013. Its date of transition to IFRSs is 1 January 2012. Entity B is engaged in the construction of various qualifying assets. Entity B's previous GAAP accounting policy was to expense borrowing costs as incurred. Entity B has the following options:

- (a) to adopt IAS 23 retrospectively. Entity B would then restate all qualifying assets as if it had always applied IAS 23 in its opening IFRS statement of financial position and throughout its first IFRS financial statements.
- (b) to apply IFRS 1.D23. The carrying amount for 1 January 2012 is not restated and is determined by the previous GAAP. Entity B capitalises borrowing costs incurred on or after 1 January 2012 (including borrowing costs that relate to qualifying assets under construction at 1 January 2012) in accordance with IAS 23.
- (c) to designate an earlier date. For example, entity B could designate 1 September 2010 as the date for adoption of IAS 23. The carrying amount for 1 September 2010 is not restated and is determined by the previous GAAP. Entity B should capitalise borrowing costs incurred on or after 1 September 2010 (including borrowing costs that relate to qualifying assets under construction at 1 September 2010) in accordance with IAS 23.

2.15.1 IFRS 1 deemed cost option

Independently of its choices under IFRS 1.D23 and its previous GAAP policy for borrowing costs, the first-time adopter may apply the exemptions in IFRS 1.D5 – 8. This allows the first-time adopter to measure items of property, plant and equipment or investment properties (provided the entity has elected to use the cost model in IAS 40 'Investment Property') at fair value, a previous GAAP revaluation or an event-driven fair value (see paragraph 2.3 above). These amounts are treated as the deemed cost of the asset(s). If the first-time adopter decides to do this, it effectively ignores the treatment of borrowing costs incurred on the applicable assets up to the transition date (or the date of the measurement that established the deemed cost if earlier) (IFRS 1.IG23).

2.16 Investments in subsidiaries, joint ventures and associates

This exemption is relevant only for a first-time adopter that is: (i) a parent or investor; and (ii) presents separate financial statements. Separate financial statements are not consolidated financial statements but are those financial statements presented by a parent, an investor in an associate or in a joint venture.

In accordance with IAS 27 'Separate Financial Statements' (IAS 27), a parent entity records investments in subsidiaries in its separate financial statements either at cost or in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' (IAS 27.38). Similar requirements apply to investments in associates and joint ventures in the investor's separate financial statements.

IFRS 1.D14 – 15 allow a first-time adopter to use a deemed cost when measuring an investment in a subsidiary, joint venture or associate in the separate opening statement of financial position. This deemed cost can be determined using either fair value at the date of transition to IFRSs or a previous GAAP carrying amount at that date. A first-time adopter is able to choose whether to use the deemed cost exemption on an investment-by-investment basis for each subsidiary, joint venture entity or associate.

2.17 Transfers of assets from customers

A first-time adopter may apply the transitional provisions in IFRIC 18 ‘Transfers of Assets from Customers’ (IFRIC 18). IFRIC 18 generally requires an entity that receives an item of property, plant and equipment from a customer to recognise an asset and measure its cost at initial recognition at fair value in accordance with IAS 16 if that item meets the definition of an asset as set out in the Framework. In applying this exemption the first-time adopter may apply the requirements of IFRIC 18 prospectively from:

- 1 July 2009 or the date of the transition, whichever is later, or
- a date earlier than the date of the transition to all transfers of assets from customers received on or after that date (IFRS 1.D24).

2.18 Extinguishing financial liabilities with equity instruments

IFRIC 19 ‘Extinguishing Financial Liabilities with Equity Instruments’ (IFRIC 19) deals with so-called ‘debt for equity’ exchanges. Broadly, IFRIC 19 requires a borrower that negotiates to settle a financial liability by issuing its own shares (equity instruments) to the lender to recognise a gain or loss for the difference between the shares’ fair value and the carrying value of the liability extinguished.

IFRS 1 contains an exemption allowing first-time adopters to apply the transitional provisions in IFRIC 19 (IFRS 1.D25). This exemption simplifies the transition by requiring retrospective application only from the beginning of the earliest comparative period presented. For first-time adopters this means that, in effect, IFRIC 19 needs to be applied only from the date of transition to IFRSs. The logic behind these requirements is that a retrospective application for earlier periods would result only in a reclassification within equity.

Example C.16: Extinguishing financial liabilities with equity instruments

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. Its date of transition to IFRSs is 1 January 2011. On 2 January 2010, entity A issued equity instruments with a fair value of CU 5,000 to extinguish 50% of ‘Series A’ bonds that had been recognised as liabilities in its balance sheet.

On 2 January 2011, entity A issued more equity instruments with fair value of CU 5,500 to extinguish the remaining 50% of ‘Series A’ bonds.

Entity A can use the exemption in IFRS 1.D25 and apply the requirements of IFRIC 19 only to the extinguishment of the liability on 2 January 2011. Applying the requirements of IFRIC 19 to the extinguishment of the liability on 2 January 2010 is not required and would result in only a reclassification within equity.

2.19 Stripping costs in the production phase of a surface mine

IFRIC 20 ‘Stripping Costs in the Production Phase of a Surface Mine’ (IFRIC 20) addresses the accounting treatment of costs incurred by mining companies in removing mine waste materials to gain access to mineral ore deposits during the production phase of the mine. IFRIC 20 requires stripping costs that meet certain criteria to be recognised as an inventory or non-current asset (tangible or intangible), depending on the benefits of the related activity. IFRIC 20’s transitional provisions require prospective application to production of stripping costs incurred on or after the beginning of the earliest period presented and contains guidance about how to deal with an existing stripping cost asset.

A first-time adopter may apply the transitional provisions in IFRIC 20 from the later of:

- 1 January 2013 or
- the beginning of the first IFRS reporting period (IFRS 1.D32).

2.20 Severe hyperinflation

IFRS 1.D26 – 30 provide certain reliefs for a first-time adopter whose functional currency was subject to hyperinflation but ‘normalises’ prior to the date of transition. In summary, such an entity may elect to:

- measure all assets and liabilities held before the functional currency’s ‘normalisation’ date at fair value and
- use that fair value as the deemed cost in the opening IFRS financial statement of financial position.

2.21 Joint arrangements

IFRS 11 ‘Joint Arrangements’ (IFRS 11)⁹ classifies joint arrangements into two types: joint ventures and joint operations. IFRS 11 requires a joint operator to account for its share of assets, liabilities, revenue and expenses and a joint venturer to apply the equity method in accounting for its investment.

IFRS 11 contains detailed transitional provisions (see IFRS 11.C). Briefly, the main transitional provisions of IFRS 11 are as follows:

- transition from proportionate consolidation to the equity method: the entity recognises its investment in the joint venture at the beginning of the immediately preceding period as the aggregated carrying amounts of assets and liabilities recognised under proportionate consolidation, including goodwill, at that date. It then tests the investment (including the goodwill) for impairment following the requirements of IAS 28 (as amended in 2011). If relevant, it recognises an impairment as an adjustment to the retained earnings at the beginning of the immediately preceding period
- transition from the equity method to accounting for assets and liabilities: the entity derecognises its equity-method investment at the beginning of the immediately preceding period and instead recognises its share in the individual assets and liabilities based on amounts that formed part of the investment (including goodwill). If the net amount of the assets and liabilities (including goodwill) is higher than the derecognised investment then any differences are first offset against goodwill with any remaining excess adjusted against retained earnings at the beginning of the immediately preceding period. If the net amount of the assets and liabilities (including goodwill) is lower than the derecognised investment then any differences are adjusted against retained earnings at the beginning of the immediately preceding period.

IFRS 1.D31 allows a first-time adopter to apply the transitional provisions in IFRS 11 at the date of transition with the following modifications:

- the first-time adopter must test the investment for impairment in accordance with IAS 36 at the date of transition when changing from proportionate consolidation to the equity method, regardless of whether any indications of impairment have been identified
- the adjustments required on transition should be reflected at the date of transition.

The IFRS 1.D31 relief is relevant only if the application of IFRS 11 changes the classification of the investment compared to its previous GAAP classification. However, for investments in joint ventures (based on IFRS 11’s classification) made before the date of transition the business combination relief discussed in paragraph 2.1 can be applied (IFRS 1.C5). To illustrate, consider the following examples:

⁹ IFRS 11 is effective for annual periods beginning on or after 1 January 2013. Early application is permitted but only if IFRS 10 ‘Consolidated Financial Statements’, IFRS 12 ‘Disclosure of Interests in Other Entities’, IAS 27 (Revised) ‘Separate Financial Statements’ and IAS 28 (Revised) ‘Investments in Associates and Joint Ventures’ are also adopted at the same time.

Example C.17: Joint arrangement – transition from the equity method

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2013. Its date of transition to IFRSs is 1 January 2012. Entity A's previous GAAP accounting policy was to account for its interests in joint arrangements using the equity method.

On transition to IFRSs, entity A is required to reassess the classification of its joint arrangements (as either joint ventures or joint operations) on the basis of IFRS 11's criteria.

For an investment classified as a joint venture entity A is required to apply equity accounting in accordance with IAS 28 retrospectively. Entity A should therefore identify if there are any differences between the application of the equity method in accordance with its previous GAAP and the requirements of IAS 28. In addition, entity A may elect to use the relief in IFRS 1.C5 for investments in associates and joint ventures (see paragraph 2.1, business combinations, above).

For an investment classified as a joint operation, entity A has the following options:

- (a) to apply IFRS 11 retrospectively. Entity A then accounts for its assets, liabilities, revenue and expenses in accordance with IFRS 11 as though it had always done so (in preparing its opening statement of financial position and throughout its first IFRS financial statements). It can also apply any other reliefs available in IFRS 1 for the specific types of asset or liability in question
- (b) to apply IFRS 1.D31. Entity A then derecognises its equity-accounted investment and recognises its interests in the assets and liabilities (including goodwill) at 1 January 2012. It can also apply any other reliefs available in IFRS 1 for the specific types of asset or liability in question. If the net amount of the assets and liabilities (including goodwill) is higher than the derecognised investment then any differences are first offset against goodwill with any remaining excess adjusted against retained earnings at 1 January 2012. If the net amount of the assets and liabilities (including goodwill) is lower than the derecognised investment then any differences are adjusted against retained earnings at 1 January 2012.

Example C.17A: Joint arrangement – transition from the proportionate consolidation method

Entity B will prepare its first IFRS financial statements for the year ended 31 December 2013. Its date of transition to IFRSs is 1 January 2012. Entity B's previous GAAP accounting policy was to account for its interests in joint arrangements using proportionate consolidation.

On transition to IFRSs, entity B is required to reassess the classification of its joint arrangements (as either joint ventures or joint operations) on the basis of IFRS 11's criteria.

For an investment classified as a joint operation entity B is required to account for its share of assets, liabilities, revenue and expenses in accordance with IFRS 11 as though it had always done so. It may also use any other reliefs available in IFRS 1 for the specific types of asset or liability in question.

For an investment classified as a joint venture, entity B has the following options:

- (a) to apply IFRS 11 retrospectively. Entity B would then apply equity accounting in accordance with IAS 28 as though it had always done so (in preparing its opening statement of financial position and throughout its first IFRS financial statements)
- (b) to apply IFRS 1.D31. Entity B then recognises an equity-accounted investment at 1 January 2012 on the basis of the aggregated assets and liabilities (including goodwill) recognised in proportionate consolidation. Entity B must test the investment for impairment in accordance with IAS 36 at 1 January 2012
- (c) to use the relief in IFRS 1.C5 (see paragraph 2.1, business combinations, above).

3 Mandatory exemptions

Some consequences of retrospective application by a first-time adopter are considered inappropriate by the IASB and are therefore prohibited. The prohibitions are included in IFRS 1 Appendix B (IFRS 1.B) and IFRS 1.13 – 17 and address specific requirements of the underlying IFRSs in the following areas:

- derecognition of financial assets and financial liabilities
- hedge accounting
- estimates
- consolidation and non-controlling interests and
- government loans.

3.1 Derecognition of financial assets and financial liabilities

A first-time adopter may have derecognised financial assets and financial liabilities under previous GAAP, as a result of a transaction which may not have qualified for derecognition in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' (IAS 39). Retrospective application of IAS 39 would imply recognising those assets and liabilities at the date of transition to IFRSs. This could be a costly and complex exercise.

IFRS 1 exempts a first-time adopter from recognition of non-derivative financial assets and non-derivative financial liabilities that were derecognised under previous GAAP before the date of transition (IFRS 1.B2). In effect, this means applying the derecognition requirements in IAS 39 prospectively to transfers occurring on or after the date of the transition.

However, the first-time adopter may, in accordance with IFRS 1.B3, apply the derecognition requirements of IAS 39 retrospectively from a date of its choosing provided that the information needed was obtained at the time of initially accounting for these transactions. In practice, this election permits the first-time adopter to apply IAS 39's derecognition requirements from a designated date prior to the date of transition. The condition in IFRS 1.B3 (on having obtained information) limits the ability to selectively 're-recognise' financial assets and liabilities, which would be an unacceptable use of hindsight.

3.2 Hedge accounting

A first-time adopter may have applied a form of hedge accounting under its previous GAAP. In many cases the first-time adopter's detailed application of hedge accounting under local GAAP will not comply with IAS 39's extensive requirements (primarily concerning designation, documentation and testing for effectiveness). Retrospective application of the requirements in IAS 39 could lead to selective designation of hedge accounting using hindsight (for example, by designating a derivative as a hedging instrument only if so doing has a positive effect on profit or loss). Use of hindsight is contrary to IAS 39's hedge accounting rules for an ongoing IFRS entity.

IFRS 1 therefore permits a first-time adopter to adopt hedge accounting in its opening statement of financial position only for relationships:

- that have been designated as hedges under previous GAAP and
- which also qualify for hedge accounting under IAS 39 (IFRS 1.B5 and IFRS 1.IG60).

Hedge accounting is then applied from the date that the hedging relationship is fully designated and documented in accordance with the requirements in IAS 39. The designation and documentation must be completed by the date of transition if hedge accounting is to be applied to a specified arrangement from that date. Retrospective designation is prohibited.

It is also important to note that, when the foregoing requirements are met, IAS 39's hedge accounting rules are applied from the date that the hedging relationship is fully documented and designated (not from the date of transition). This may for example require the creation of a cash flow hedge reserve at the transition date, or making a fair value hedging adjustment when measuring the hedged item in a fair value hedge. The adjustments required will depend on the differences (if any) between the 'mechanics' of hedge accounting under previous GAAP and under IAS 39.

IFRS 1 also addresses situations in which the first-time adopter, before the date of transition, designated an arrangement for hedge accounting under previous GAAP but IAS 39's requirements are not met. In that case the first-time adopter discontinues hedge accounting under IFRSs in accordance with IAS 39.91 and IAS 39.101 (IFRS 1.B6). In effect, this means that all hedging relationships identified as such under previous GAAP must be examined for compliance with IAS 39 at the date of transition. If a hedge does not meet IAS 39's requirements for hedge accounting (i) the derivative is classified as held for trading at the date of transition and subsequently measured at fair value through profit or loss; and (ii) adjustments made to the hedged item in applying fair value hedging, and gains or losses deferred in equity under cash flow hedging, are dealt with in the same way as a designated IAS 39 hedge accounting relationship that ceases to meet the applicable conditions.

IFRS 1.B5 also includes one relaxation of this generally strict approach. If a first-time adopter has 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 under IFRSs. This re-designation must be effected no later than the date of transition to IFRSs.

To comply with IAS 39 the first-time adopter reflects its financial instruments in its opening statement of financial position. This means that, in all situations, a first-time adopter:

- measures all derivatives at fair value and
- eliminates all deferred losses and gains arising on derivatives that were reported under previous GAAP as if they were assets or liabilities (ie that were included as debits or credits in the statement of financial position) (IFRS 1.B4).

The first-time adoption of IFRSs in this area, and the interaction with IAS 39, are complex. Further guidance is included in Appendix II.5.

3.3 Estimates

In preparing the opening statement of financial position and comparative information in its first IFRS financial statements, the first-time adopter may have received (new) information about estimates that it made for the same dates under previous GAAP. IFRS 1.14 states the principles which apply to estimates at the date of transition to IFRSs and for comparative periods in the first IFRS financial statements:

"An entity's estimates in accordance with IFRSs at the date of transition to IFRSs shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error."

Where previous GAAP required estimates of similar items using an accounting policy consistent with IFRSs and there is no objective evidence of an error in these estimates, estimates for IFRSs purposes are the same as those under previous GAAP. The first-time adopter treats later information as a non-adjusting event as defined in IAS 10 'Events after the Reporting Period' (IAS 10) – IFRS 1.15. The effects of changes to the previous estimates are then recognised in the period in which the entity receives new information and revises its estimates based on that information. This is a modification to the normal IAS 10 principles on distinguishing between adjusting and non-adjusting events (see IFRS 1.IG3).

Where previous GAAP required estimates of similar items using an accounting policy that is not consistent with IFRSs, the estimates under IFRSs still need to be consistent with those under previous GAAP after adjusting for the difference in accounting policies (unless there is objective evidence of an error). For example, if previous GAAP required a first-time adopter to measure provisions on an undiscounted basis, the first-time adopter uses the same underlying information that it used under previous GAAP in determining a discounted provision under IFRSs (IFRS 1.IG3).

If a first-time adopter was not required to make estimates under previous GAAP but IFRSs require estimates in the opening (or comparative) statement of financial position, then it uses information that existed at the date of transition or the date of the comparative period (market prices, interest rates, foreign exchange rates at that date) (IFRS 1.16). This is consistent with the approach in IAS 10 to non-adjusting and adjusting events after the reporting period.

If a first-time adopter determines that there is objective evidence of an error (see IAS 8), it revises the estimates made under previous GAAP and uses the revised estimate in the opening statement of financial position or in the comparative period. In its explanation of transition to IFRSs the first-time adopter shall distinguish errors made under previous GAAP from changes in accounting policies (see section D).

Example C.18: Estimates

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. Its date of transition to IFRSs is 1 January 2011.

Under its previous GAAP, entity A did not recognise a provision for a court case arising from events that occurred in September 2010 in the financial statements for the year ended 31 December 2010. The court case was subsequently concluded on June 2011, with entity A being required to make a payment of CU 1,000 to settle the case.

Application of requirements

Scenario 1 – entity A's previous GAAP was consistent with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' but entity A concluded that the outflow of economic benefit as a result of the case was not probable

Entity A concluded that the recognition criteria were not met. In this case, entity A's assumptions under IFRSs are consistent with its assumptions under previous GAAP. Therefore, assuming that these conclusions were not in error, entity A does not recognise a provision at 1 January 2011 under IFRSs.

Scenario 2 – entity A's previous GAAP was not consistent with IAS 37 and did not permit a provision for the lawsuit prior to the settlement. As a result, entity A did not consider the need for a provision prior to settlement. A provision would have been required under IAS 37

Entity A must develop an estimate of the obligation under IAS 37 at 1 January 2011. Under IAS 37, an entity determines whether an obligation exists at the end of the reporting period by taking account of all available evidence, including any additional evidence provided by events after the reporting period. Similarly, under IAS 10 'Events after the Reporting Period', the resolution of a court case after the reporting period is an adjusting event if it confirms that the entity had a present obligation at that date. In this instance, the resolution of the court case confirms that entity A had a liability in September 2010 (when the events occurred that gave rise to the court case). Therefore, entity A recognises a provision at 1 January 2011. Entity A measures that provision by discounting the CU 1,000 paid on July 2011 to its present value at 1 January 2011, using a discount rate that complies with IAS 37 and reflects market conditions at 1 January 2011.

3.4 Consolidation and non-controlling interests

In general, the first-time adopter applying IFRS 10¹⁰ does so retrospectively from the date of transition. This means that, in preparing its first IFRS financial statements, the first-time adopter applies the requirements of IFRS 10 to determine which investees it controls (ie its subsidiaries) and does not control and, if applicable, the dates on which control was obtained or lost. In preparing its first IFRS financial statements the first-time adopter consolidates its subsidiaries from the date control was obtained to the date control was lost as though it had always done so (subject to the important relief in IFRS 1.C4(j) – see paragraph 2.1.6 above).

IFRS 1.B7(a) – (c) set out exceptions to this retrospective approach, relating to accounting for non-controlling interests and loss of control. The exceptions require that the following requirements of IFRS 10 are applied prospectively from the date of transition, unless IFRS 3 is applied retrospectively to past business combinations. The exceptions are:

¹⁰ IFRS 10 is effective for annual periods beginning on or after 1 January 2013. Early application is permitted but only if IFRS 11, IFRS 12, IAS 27R, IAS 28R are also adopted at the same time.

- the requirements in paragraph B94 of IFRS 10 requiring attribution of total comprehensive income to the owners of the parent and to the non-controlling interest even if this results in the non-controlling interests having a deficit balance
- the requirements on accounting for changes in the parent's ownership interests in a subsidiary after control is obtained (IFRS 10.23 and IFRS 10.B96) and
- the requirements on accounting for a loss of control of a subsidiary (IFRS 10.B97 – 99) and the related requirements of IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' to classify assets and liabilities of that subsidiary as held for sale (IFRS 5.8A).

If a first-time adopter elects to restate a pre-transition date business combination in accordance with IFRS 3, this also brings forward the date when it applies IFRS 10. To illustrate, consider a first-time adopter with a date of transition of 1 January 2011 that elects to apply IFRS 10:

- if the first-time adopter does not restate past business combinations, the provisions in IFRS 1.1.B7(a) – (c) are applied prospectively from the date of transition (1 January 2011)
- the first-time adopter restates a business combination that occurred on 1 January 2010, it also restates all other business combinations that occurred from 1 January 2010 to its date of transition (IFRS 1.C1). IFRS 10 is also applied from 1 January 2010.

Transitional provisions of IFRS 10

IFRS 10 contains transition reliefs that intend to limit the burden of retrospective application of the standard for an ongoing IFRS preparer. An entity is not required to apply IFRS 10 retrospectively:

- if the consolidation conclusion reached at the date of initial application of IFRS 10 is the same when applying IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation—Special Purpose Entities'
- to interests in investees that were disposed during a comparative period in such a way that consolidation would not occur in accordance with either IAS 27/SIC-12 or IFRS 10 at the date of initial application.

These transition reliefs also limit the requirement to present adjusted comparatives to the period immediately preceding the date of initial application.

These reliefs are not available for a first-time adopter. This means that a first-time adopter that elects to apply IFRS 10 before the date of mandatory application, or applies IFRSs on or after 1 January 2013, is required to apply IFRS 10 retrospectively (except for the exceptions in IFRS 1.B7). The fact that the IASB did not provide a first-time adopter with these reliefs can appear burdensome, particularly when the entity lost control of an investee during a comparative period. To illustrate, consider example C.19 below.

Example C.19: IFRS 10's transitional provisions

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2013. Its date of transition to IFRSs is 1 January 2012. Entity A acquired an interest in investee B on 1 January 2000. On 30 September 2012, entity A sold its interests in investee B.

Entity A was not required to consolidate investee B in accordance with its previous GAAP or with IAS 27. However, Entity A has to consolidate investee B in accordance with IFRS 10.

Application of requirements

IFRS 10 is effective for annual periods beginning on or after 1 January 2013 and must be applied retrospectively by a first-time adopter. Therefore entity A needs to consolidate investee B at its date of transition to IFRSs and until 30 September 2012. It therefore should present the effects of the consolidation in the comparative period when preparing its first IFRS financial statements for the year ended 31 December 2013.

If investee B is a business, entity A can use the relief in IFRS 1.C4(j) which applies when a first-time adopter consolidates a subsidiary acquired in a business combination that was not consolidated in accordance with previous GAAP. Entity A then records investee B's assets and liabilities at the date of transition at the amounts that IFRSs would require in investee B's individual IFRS financial statements. Goodwill is then determined as the difference between entity A's interest in these adjusted carrying amounts and entity A's cost of investment.

3.5 Government loans

IAS 20 'Accounting for Government Grants and Disclosure of Government Assistance' (IAS 20) requires an entity to measure a government loan with a below market interest rate on initial recognition at fair value in accordance with IAS 39, with the corresponding benefit being accounted for as a government grant. The benefit is measured as the difference between the proceeds received and the initial carrying amount of the loan determined in accordance with IAS 39. The loan is subsequently measured in accordance with IAS 39.

A first-time adopter (that did not account for government loans in this manner under previous GAAP) is required to:

- apply IAS 32 to classify government loans received as financial liabilities or equity instruments
- measure government loans at the date of transition to IFRSs at their previous GAAP carrying amount without recognising the benefit element as a government grant
- apply IAS 39 to measure the loans subsequently using an effective interest rate calculated at the date of transition and
- apply IAS 20 to government loans received after the date of transition.

Notwithstanding these requirements, a first-time adopter may apply the requirements in IAS 39 and IAS 20 retrospectively to a government loan originated before the date of transition to IFRSs (on a loan-by-loan basis), provided that the information needed to do so had been obtained at the time of initially accounting for that loan (IFRS 1.B10 – 12).

Example C.20: Government loans below market interest rate

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2013. Its date of transition to IFRSs is 1 January 2012. Entity A operates in country B. On 1 January 2011, entity A received a loan of CU 500,000 at an annual interest rate of 1% from the government. The loan and the accumulated interest will be repayable on 1 January 2016.

Entity A's previous GAAP accounting policy was to account for the government loan as equity. The carrying amount under previous GAAP at 1 January 2012 is CU 500,000

Application of requirements

Entity A is required:

- to apply IAS 32 at 1 January 2012. The government loan meets the definition of a financial liability in accordance with IAS 32. Entity A should reclassify the government loan from equity to liability at 1 January 2012
- to measure the loan at its previous GAAP carrying amount at 1 January 2012 (CU 500,000)
- to apply IAS 39 after 1 January 2012, which requires it to calculate the effective interest rate at 1 January 2012. Entity A needs to repay CU 525,000 at 1 January 2016. Therefore, the effective interest rate at 1 January 2012 is: $(525,000/500,000)^{(1/4)} - 1 =$ approximately 1.23%. The carrying amount of the loan at subsequent dates is then:

Date	Carrying amount	Interest expense at approximately 1.23%
	CU	CU
1 January 2012	500,000	
31 December 2012	506,136	6,136
31 December 2013	512,347	6,211
31 December 2014	518,635	6,288
31 December 2015	525,000	6,365

- entity A should apply the requirements of IAS 20 and IAS 39 to any government loan below market rate received after 1 January 2012.

4 Future developments

The IASB has no specific plan to amend IFRS 1 at the date of publication of the guide (October 2012).

However, IFRS 1 is a dynamic standard that is changed frequently to:

- reflect changes in other IFRSs (including the revision of current standards and the publication of new standards)
- incorporate additional transition reliefs in reaction to specific situations (for example, jurisdictional issues as additional countries adopt IFRSs).

Of the IASB's current projects, the continuing development of IFRS 9 'Financial Instruments' (as a replacement of IAS 39) is especially noteworthy. IFRS 9 has already resulted in changes to IFRS 1 and further changes can be expected as the project progresses to completion. As noted in the introduction section, the effects of IFRS 9 are not reflected in this guide.

D. Presentation and disclosure

Summary of requirements

- A. In general the first-time adopter shall present at least the same disclosures as all other entities reporting under IFRSs.
- B. The disclosure requirements generally apply for comparative information as well.
- C. Additional disclosure requirements apply for a first-time adopter. The entity shall prepare reconciliations between previous GAAP and IFRSs and disclose these reconciliations in its first IFRS financial statements (and interim reports, if applicable). These disclosures provide vital information about the transition to IFRSs.
- D. The requirement for reconciliations between previous GAAP and IFRSs also applies in a first-time adopter's interim reports for part of the period covered by its first IFRS financial statements.

1 General requirements

The change of primary GAAP may have significant consequences for the measurement of a first-time adopter's assets, liabilities, income and expenses. Users of the financial statements require information on the impact of the transition to IFRSs on profits, equity and other items in the financial statements. Such information is essential in the first IFRS financial statements, and also in the IFRS interim reports, because it helps users understand the effect and implications of the transition to IFRSs and to make better use of the information presented under IFRSs.

A first-time adopter must present the same information as all other entities reporting under IFRSs. IFRS 1 states that there are no exemptions to the presentation and disclosure requirements in other IFRSs (IFRS 1.20). In general, this means that a first-time adopter should have the information available to comply with disclosure requirements throughout all reporting periods in its first IFRS financial statements.¹¹

This section covers the specific disclosures for a first-time adopter required by IFRS 1.

2 Primary statements and comparative information

IAS 1 introduced the requirement for a statement of financial position at the beginning of the earliest comparative period in certain circumstances (often referred to as a third statement of financial position). Accordingly, IFRS 1 was amended to require that a first-time adopter presents at least:

- three statements of financial position (at the end of the current period and the two comparative periods)
- two of each of the other IFRS primary statements (covering the current period and the comparative period)
- related notes (IFRS 1.21).

¹¹ Grant Thornton International has published 'First-time Adoption of IFRS – Example Consolidated Financial Statements'. These example financial statements illustrate the first-time adoption of IFRSs for the year ending 31 December 2011. They have been updated to reflect changes in IFRSs up to 15 December 2011.

In effect, this means that a first-time adopter presents its transition date statement of financial position as a comparative statement. Regulatory requirements in certain jurisdictions may require further comparative periods. The periods and period-end dates covered by the notes to the financial statements follow the requirements for primary statements. Accordingly, assuming the first-time adopter's primary statements cover the minimum periods specified:

- notes relating to the statement of profit and loss and other comprehensive income, cash flow statement and statement of changes in equity cover the current period and one comparative period and
- notes relating to the statement of financial position cover the period end and the two preceding period ends (the earliest of which is also the date of transition to IFRSs).

This means that a first-time adopter presents note disclosures covering its statement of financial position at its date of transition. In some cases, however, the related notes to the opening statement of financial position are not straightforward (see discussion below).

2.1 Historical summaries

Some entities present historical summaries of selected information for periods before the first period for which they present full comparative information under IFRSs. For example, in many jurisdictions entities are required to present five-year summaries. IFRS 1 does not require such summaries to comply with the recognition and measurement requirements of IFRSs for periods before full comparative information under IFRSs is presented (IFRS 1.22). However, the information presented under previous GAAP shall:

- be prominently labelled as previous GAAP information not being prepared under IFRSs and
- disclose the nature of the main adjustments that would make it comply with IFRSs. The adjustments need not be quantified (IFRS 1.22).

2.2 Related notes

As noted, IFRS 1.21 requires a first-time adopter to present at least three statements of financial position and related notes. This requirement was introduced as a consequence of IAS 1. For a first-time adopter, this third statement of financial position corresponds to the opening statement of financial position at the date of transition. It is our view that 'related notes' should be interpreted to include notes for the (additional) third statement of financial position.

When IFRSs disclosures require information about movements in assets or liabilities relating to a period (reconciliations), this triggers questions about whether this is a related note for the purpose of this opening statement of financial position. In our view, these reconciliations are not generally required for the period ending on the date of transition. To illustrate, consider example D.1 below for a first-time adopter that applies the fair value as deemed cost exemption in IFRS 1.

Example D.1: Application of notes for third statement of financial position

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. It presents only one full comparative period and its date of transition to IFRSs is 1 January 2011. In accordance with IFRS 1.21 the first-time adopter is required to present three statements of financial position and related notes.

Entity A has property, plant and equipment. For some items of property, plant and equipment the entity elects to use the fair value as deemed cost exemption in IFRS 1. Entity A measures these items at fair value at 1 January 2011 and then uses the cost-method in IAS 16 to account for them. The carrying amount at 1 January 2011 is the fair value at this date.

In accordance with IAS 16.73(e) an entity presents a reconciliation of the carrying amount at the beginning and end of the reporting period. Is this reconciliation required at 31 December 2010?

Application of requirements

In our view, it is not. This is because the reconciliation relates to a reporting period and need not therefore be viewed as a related note for the statement of financial position at 31 December 2010. Accordingly, in our view it provides the information specified by IAS 16.73(e) for 2011 and 2012, but not for 2010.

In any case entity A will not be able to present the reconciliation for 2010 because it measures some items at fair value at the date of transition. Entity A does not therefore determine IFRS-based amounts for those items prior to the date of transition.

3 Explanation of transition to IFRSs

IFRS 1.23 states:

“An entity shall explain how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cash flows.”

This explanation helps users understand the material adjustments to the statement of financial position, the statement of comprehensive income and cash flows. Such information is essential because it helps users understand the effect and implications of the transition to IFRSs. For example, an investor will need information about the effects of IFRSs' transition on profits.

To comply with IFRS 1 a first-time adopter includes in its first IFRS financial statements:

- reconciliations of equity between previous GAAP and IFRSs and
- reconciliation of total comprehensive income between previous GAAP and IFRSs (IFRS 1.24(a) – (b)).

These reconciliations are discussed in more detail below. IFRS 1.24(a) – (b) do not directly address the form and content of the reconciliations. However, IFRS 1.25 includes a further requirement to the effect that the overall information provided should be sufficient to enable users to understand the material adjustments to those statements. In practice, this is often achieved by supplementing the IFRS 1.24(a) – (b) reconciliations with additional narrative descriptions of other adjustments (see also IFRS 1.BC92).

If a first-time adopter did not present financial statements for previous periods, the reconciliations cannot be prepared. Accordingly, the first-time adopter does not present the reconciliations in these circumstances and discloses that fact (IFRS 1.28).

3.1 Reconciliations of equity

IFRS 1.24(a) requires that an entity discloses in its first IFRS financial statements:

“reconciliations of its equity reported in accordance with previous GAAP to its equity in accordance with IFRSs for both of the following dates:

- (i) the date of transition to IFRSs; and
- (ii) the end of the latest period presented in the entity's most recent annual financial statements in accordance with previous GAAP.”

Consider the following example:

Example D.2: Reconciliations of equity

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. It presents only one full comparative period and its date of transition to IFRSs is 1 January 2011. Entity A presented its last financial report under its previous GAAP as at 31 December 2011.

Entity A is required to present reconciliations between equity under previous GAAP and IFRSs at:

- (i) 1 January 2011 (date of transition)
- (ii) 31 December 2011 (the end of the latest period presented under previous GAAP)

If entity A presented two years of full comparative information the transition date would be 1 January 2010, which leaves a gap in the reconciliations. The standard is silent on this situation. Entities may choose to present an additional reconciliation to provide users with comprehensive information on the transition to IFRSs.

Adjustments made by a first-time adopter in restating its opening statement of financial position from previous GAAP to IFRSs are generally made to retained earnings (or, if appropriate, another category of equity, or goodwill). Adjustments arising from differences in accounting policies under IFRSs therefore affect equity (and the reconciliations of equity).

IFRS 1 does not specify the form and content of the reconciliation and is silent on what constitutes sufficient detail. The implementation guidance in IFRS 1 includes an example of a reconciliation (IFRS 1.IG Example 11), which is often used in practice. The example presents the movements in each line item within the statement of financial position from previous GAAP to IFRSs with accompanying footnotes. The implementation guidance shows only one way of satisfying the requirements. Entities may find other forms of presentation preferable.

Included in paragraph 3.3 is an example of reconciliations based on the guidance in IFRS 1.IG Example 11.

A question arises about whether the first-time adopter is required to present a reconciliation of its equity if it has never prepared consolidated financial statements as defined in IAS 1 but is required to present consolidated financial statements in accordance with IFRSs. In our view, the fact that the first-time adopter did not prepare consolidated financial statements under its previous GAAP does not exempt it from IFRS 1.24(a)'s requirements to present a reconciliation of its equity both at the date of transition to IFRSs and at the end of the latest period presented in its most recent annual financial statements in accordance with previous GAAP. We believe that the appropriate starting point for those reconciliations is the amounts reported in the separate financial statements under its previous GAAP. The first time adopter should present the adjustments necessary to take the amounts that were reported in those separate financial statements to the carrying amounts in its IFRS consolidated financial statements. One acceptable method of presenting the adjustments would be to use two columns: one column showing the adjustments made to reflect the conversion of the amounts previously reported in the first time adopter's separate financial statements to IFRSs and a second column showing the effect of the consolidation.

3.2 Reconciliation of total comprehensive income

IFRS 1.24(b) requires that an entity shall disclose in its first IFRS financial statements:

“a reconciliation to its total comprehensive income in accordance with 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 acknowledges that previous GAAP might not include a concept such as total comprehensive income, and therefore allows profit or loss to be used as a starting point. The starting point therefore depends on previous GAAP – profit or loss is used only if a statement corresponding to total comprehensive income was not presented under previous GAAP. The reconciliation is presented for the latest period in the most recent financial statements presented under previous GAAP. Consider the following example:

Example D.3: Reconciliation of total comprehensive income

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. It presents only one full comparative period and its date of transition to IFRSs is 1 January 2011. Entity A presented its last financial report under previous GAAP as at 31 December 2011.

Entity A is required to present a reconciliation between total comprehensive income under previous GAAP and IFRSs for the period 1 January 2011 to 31 December 2011.

If entity A presented two years of full comparative information the transition date would be 1 January 2010. IFRS 1 does not require a reconciliation for the period ended 31 December 2010. Entities may choose to present an additional reconciliation to provide users with comprehensive information on the transition to IFRSs.

The implementation guidance in IFRS 1 includes an example illustrating one way in which the requirements may be met (IFRS 1.IG Example 11). This approach is often used in practice. Narrative descriptions are required for the adjustments. Set out in paragraph 3.3 below is an example of how requirements may be met based on this implementation guidance. The standard is silent on the inclusion of earnings per share in the reconciliation.¹² We consider it good practice that the first-time adopter should explain the effect on earnings per share.

3.3 Example of reconciliations

This section presents an example of how a reconciliation may be presented. The first-time adopter presents its first IFRS financial statements for the period ended 31 December 2012. Its date of transition is 1 January 2011.

Reconciliation of equity

	Note	1 January 2011			31 December 2011		
		Previous GAAP	Effect of transition to IFRSs	IFRSs	Previous GAAP	Effect of transition to IFRSs	IFRSs
		CU	CU	CU	CU	CU	CU
Non-current							
Goodwill	1	2,830	(350)	2,480	2,230	250	2,480
Other intangible assets	1,2	4,230	1,550	5,780	5,330	1,070	6,400
Property, plant and equipment	3	9,000	200	9,200	10,350	280	10,630
Other long-term financial assets	4	630	310	940	630	360	990
Non-current assets		16,690	1,710	18,400	18,540	1,960	20,500
Current							
Inventories		6,000	–	6,000	6,800	–	6,800
Trade and other receivables		7,500	–	7,500	8,100	–	8,100
Cash and cash equivalents		3,010	–	3,010	4,710	–	4,710
Current assets		16,510	–	16,510	19,610	–	19,610
Total assets		33,200	1,710	34,910	38,150	1,960	40,110
Equity							
Share capital		3,000	–	3,000	3,000	–	3,000
Additional paid-in capital		3,050	–	3,050	3,050	–	3,050
Other components of equity	4	990	217	1,207	940	252	1,192
Retained earnings	7	7,760	175	7,935	10,910	474	11,384
Equity attributable to owners of the parent		14,800	392	15,192	17,900	726	18,626
Total equity		14,800	392	15,192	17,900	726	18,626

¹² In June 2011, the IASB amended IAS 1. IAS 1 now requires entities to group items presented in OCI into those that, in accordance with other IFRSs:

- will not be reclassified subsequently to profit or loss
- will be reclassified subsequently to profit or loss when specific conditions are met.

These amendments apply for annual periods beginning on or after 1 July 2012 (earlier application is permitted).

	Note	1 January 2011			31 December 2011		
		Previous	Effect of	IFRSs	Previous	Effect of	IFRSs
		GAAP	transition		GAAP	transition	
		to IFRSs		to IFRSs			
		CU	CU	CU	CU	CU	CU
Liabilities							
Non-current							
Pension and other employee obligations	5	–	1,000	1,000	–	1,030	1,030
Borrowings		8,000	–	8,000	7,700	–	7,700
Deferred tax liabilities	6	1,900	318	2,218	2,450	204	2,654
Non-current liabilities		9,900	1,318	11,218	10,150	1,234	11,384
Current							
Provisions		1,000	–	1,000	1,300	–	1,300
Trade and other payables		6,000	–	6,000	7,400	–	7,400
Current tax liabilities		1,500	–	1,500	1,400	–	1,400
Current liabilities		8,500	–	8,500	10,100	–	10,100
Total liabilities		18,400	1,318	19,718	20,250	1,234	21,484
Total equity and liabilities		33,200	1,710	34,910	38,150	1,960	40,110

Reconciliation of total comprehensive income for 2011

	Notes	Previous	Effect of	IFRSs
		GAAP	transition	
		to IFRSs	to IFRSs	
		CU	CU	CU
Revenue		80,500	–	80,500
Other income		1,000	–	1,000
Costs of material	2	(24,500)	320	(24,180)
Employee benefits expense	5	(44,700)	(30)	(44,730)
Depreciation, amortisation and impairment of non-financial assets	1, 2, 3	(2,900)	(120)	(3,020)
Other expenses		(2,500)	–	(2,500)
Operating profit		6,900	170	7,070
Finance costs		(2,200)	–	(2,200)
Finance income		400	–	400
Profit before tax		5,100	170	5,270
Tax expense, net	6	(1,950)	129	(1,821)
Profit for the year		3,150	299	3,449
Other comprehensive income for the year				
Items that will not be reclassified to profit or loss, net of tax		–	–	–
Items that may be reclassified subsequently to profit or loss, net of tax	4	–	(15)	(15)
Total comprehensive income		3,150	284	3,434
Profit for the year attributable to:				
Non-controlling interest		–	–	–
Owners of the parent		3,150	–	3,449
		3,150	–	3,449

Under previous GAAP the Group did not report total comprehensive income. Exchange differences on translation of foreign operations were recognised directly in equity under previous GAAP. Other items recognised in other comprehensive income under IFRSs include gains and losses on available-for-sale financial assets and share of other comprehensive income of equity accounted investments, which did not arise under previous GAAP.

Total basic earnings per share in 2011 under previous GAAP amount to CU X.XX (under IFRSs: CU X.XX), while total diluted earnings per share in 2011 under previous GAAP amount to CU X.XX (under IFRSs: CU X.XX).

Notes to the reconciliations

1. The Group has elected not to restate past business combinations that occurred before 1 January 2011. Under previous GAAP, the Group did not recognise intangible assets acquired in the acquisition of Shopmore Ltd in 2009. Under IFRSs an indefinite useful life intangible asset of CU 350 qualified for recognition in the financial statements of the subsidiary. Accordingly, this amount has been recognised at 1 January 2011. A corresponding decrease has been recorded in goodwill as the intangible asset was subsumed within goodwill under previous GAAP. As required by IFRS 1, goodwill recognised under previous GAAP has been tested for impairment at 1 January 2011. No impairment was identified. For the year ended 31 December 2011, goodwill is not amortised under IFRSs. As a result, the amortisation of goodwill as required under previous GAAP (CU 600) was reversed resulting in an increase in goodwill and corresponding reduction in the amortisation expense. The total effect of the adjustments to goodwill at 31 December 2011 is CU 250.
2. The increase in other intangible assets as at 1 January 2011 and 31 December 2011 is a result of the recognition of internally developed software used in production or administration. Under previous GAAP, development costs had been expensed as incurred. The effect upon transition is to increase other intangible assets by CU 1,200. In the year ended 31 December 2011, a further capitalisation of CU 320 was recognised reducing 'cost of material' by that amount. Increased amortisation for the year ended 31 December 2011 amount to CU 800. The total effect on the income statement for the year ended 31 December 2011 is CU 480, comprising increased amortisation expense (CU 800) and a decrease in 'cost of material' by CU 320.
3. Depreciation of property, plant and equipment was influenced by tax requirements under previous GAAP but under IFRSs reflects the useful life of the assets and their residual value. The cumulative adjustment at the 1 January 2011 increased the carrying amount of property, plant and equipment by CU 200 thereby increasing retained earnings. At 31 December 2011 the effect is a further increase of the asset by CU 80 reducing depreciation expense for the year by that amount.
4. The Group has elected to designate certain equity instruments as available-for-sale under IFRS, which under previous GAAP were measured at cost less impairment charge. Accordingly, these securities have been measured at fair value at 1 January 2011. The effect is to increase other long-term financial assets by CU 310 (31 December 2011: CU 360). The available-for-sale reserve within equity was increased by CU 217 net of tax (31 December 2011: CU 252).
5. Under previous GAAP a cash basis was used to account for defined benefit plans. A pension liability of CU 1,000 has been recorded under IFRSs. A further increase of CU 30 in this liability was recorded in the year ended 31 December 2011. The effect on profit or loss for the year ended 31 December 2011 is to increase 'employee benefits expense' by CU 30.
6. The above changes affected the deferred tax liability as follows:

	1 January 2011	31 December 2011
Deferred tax liability:	CU	CU
Other Intangible assets	465	321
Property, plant and equipment	60	84
Defined benefit plans	(300)	(309)
Other long-term financial assets	93	108
Increase in deferred tax liability	318	204

The movement in deferred tax recognised in profit or loss for 2011 is CU 129. Movement in deferred tax recognised in other comprehensive income is CU 15.

7. The above changes affected retained earnings as follows:

	1 January 2011	31 December 2011
Retained earnings:	CU	CU
Recognition of internally developed intangible assets	1,200	720
Change in depreciation of PPE	200	280
Recognition of pension liability	(1,000)	(1,030)
Deferred tax liability, recognised in retained earnings	(225)	(96)
Depreciation of goodwill	–	600
Increase in retained earnings	175	474

3.4 Presentation differences

Certain presentation differences between previous GAAP and IFRSs have no impact on reported profit or total equity. For example, the first-time adopter may have been required to present certain line items in its primary financial statements under previous GAAP that differ from the line items presented under IFRSs. The explanation of transition to IFRSs should include sufficient detail for users to understand the presentation differences to previous GAAP. Therefore, the first-time adopter should provide information on reclassifications or changes in line items where material.

3.5 Statement of cash flows

In accordance with IFRS 1.25, a first-time adopter also explains material adjustments to the statement of cash flows if such a statement was presented under its previous GAAP. IFRS 1 is silent on which periods the reconciliation is required for. Often, entities will only present one comparative year for a statement of cash flows. In this case, a reconciliation should be presented for the latest period in the most recent annual financial statements. If the first-time adopter presents one or more comparative periods, it may choose to present a reconciliation for each of the comparative periods to provide users with more comprehensive information.

The implementation guidance to IFRS 1 (IFRS 1.IG Example 11) includes an example of the disclosure requirements relating to income taxes paid during the reporting periods.

Other examples

In our view, reconciliation differences in the statement of cash flows will often arise as a result of the broader concept of 'cash and cash equivalents' in IFRSs compared to local GAAP in some jurisdictions.

Short-term, highly liquid financial assets that are readily convertible to known amounts of cash and are subject to only insignificant risk of value changes are 'cash equivalents' under IAS 7. This will require changes to the cash flow statements on transition to IFRSs in some cases.

The GAAP differences in cash flows are not always significant for entities adopting IFRSs. Accordingly, the disclosures seen in practice are often quite brief and narrative-based. However, in other cases the differences are significant. More extensive disclosures, and possibly a tabular reconciliation, may in that case be necessary to meet the IFRS 1.25 objective.

3.6 Impairments

Impairments are inevitably subject to estimates and assumptions about the future. IFRS 1 includes disclosure requirements if a first-time adopter recognises an impairment loss (or reversal) in its opening statement of financial position. IFRS 1 also clarifies that disclosures specified in IAS 36 'Impairment of Assets' for impairment losses are required in first IFRS financial statements when impairments (or reversals) are recognised in the opening statement of financial position (IFRS 1.24(c)). This disclosure provides transparency about the impairment losses recognised on the date of transition that would otherwise be subsumed within reconciliation differences.

4 Previous GAAP errors

IFRS 1.26 requires that a first-time adopter that becomes aware that an error was made under previous GAAP distinguishes errors from changes in accounting policies in its explanation of transition to IFRSs. The correction of an error under previous GAAP is then shown separately in the reconciliations required by IFRS 1.24(a) – (b) and not combined with the effects of changes in accounting policies.

Entities will have made estimates under previous GAAP based on the facts and circumstances available at that date. Changes in estimates are distinguished from prior period errors in accordance with IAS 8. IFRS 1's requirements on estimates are discussed in section C3.3.

5 Other disclosures

In accordance with IAS 8, an ongoing IFRS entity is required to provide disclosures concerning changes in accounting policies. IFRS 1 states that:

- a first-time adopter does not apply IAS 8 to changes in accounting policies that it makes when it first adopts IFRSs or changes to those policies made during the periods covered by its first IFRS financial statements
- a first-time adopter is required to disclose and explain any changes in its accounting policies or its use of the exemptions contained in IFRS 1 between its first IFRS interim financial report and its first IFRS financial statements (IFRS 1.27 – 27A).

Under the previous version of IAS 19, an entity was required to disclose the present value of the defined benefit obligation, the fair value of plan assets, the surplus or deficit in the plan and experience adjustments (IAS 19.120A(p)). This information is required for a five year period. IFRS 1.D11 states that a first-time adopter may disclose this information prospectively from the date of transition to IFRSs.

IAS 19R (see section C2.4 above) eliminates the disclosures required by IAS 19.120A(p) and deletes the exemption in IFRS 1.D11 for a first-time adopter that applies IAS 19R. Instead, a first-time adopter may apply the transitional provisions of IAS 19R, which provide relief from presenting comparative information for periods beginning before 1 January 2014 for the disclosures about the 'sensitivity' of the defined benefit obligation in accordance with IAS 19R.145 (IFRS 1.E5) – see Appendix I.3 below.

If a first-time adopter applies the transitional provisions in IFRS 1.D19 and designates previously recognised financial assets as available-for-sale or financial assets and financial liabilities as at fair value through profit or loss, it discloses the fair value of financial assets or financial liabilities designated into each category at the date of designation and their classification and carrying amount in the previous financial statements (IFRS 1.29).

If a first-time adopter uses fair value as deemed cost for an item of property, plant and equipment, investment property or an intangible asset (IFRS 1.D5 and IFRS 1.D7) then it discloses for each line item in the opening statement of financial position:

- the aggregate of those fair values and
- the aggregate adjustment to the carrying amounts reported under previous GAAP (IFRS 1.30).

This disclosure applies only to the fair value as deemed cost elections referred to. It does not apply if an event-driven fair value measurement, previous GAAP revaluation or carrying amount is used in accordance with IFRS 1.D6, IFRS 1.D8 – 8B.

6 IFRS 1 exemptions applied

It is appropriate to disclose the IFRS 1 exemptions that have been applied by a first-time adopter on transition to IFRSs. The precise format and extent of these disclosures is not prescribed in IFRS 1 but in our view this information is generally necessary to meet the requirement to explain the effects of the transition. The general requirements of IAS 1 on disclosure of accounting policies are also equally applicable to the disclosure of first-time adoption exemptions.

Some first-time adopters present these disclosures in a separate note that also includes the various disclosures prescribed by IFRS 1. Others include them within the disclosures concerning significant accounting policies under IFRSs.

We believe it is appropriate to consider disclosing both the mandatory and optional IFRS 1 exemptions where applicable.

7 Interim financial reports

IFRS 1 does not require the presentation of an interim financial report. An interim report may however be required by a securities regulator or a stock exchange (usually either quarterly or half-yearly). If an entity elects or is required to publish an interim report in accordance with IFRSs, it applies IAS 34 'Interim Financial Reporting' (IAS 34) (IFRS 1.IG37). IAS 34 permits an entity to present either 'complete' or 'condensed' interim financial statements. The following paragraphs relate primarily to the latter, condensed approach.

IFRS 1.2 specifies that its scope includes interim reports presented under IAS 34 for part of the period covered by the first IFRS financial statements. This reflects the fact that additional information is necessary to ensure that interim financial reports under IAS 34 are helpful to users when the previous annual financial statements were prepared using previous GAAP (IFRS 1.BC96). IFRS 1 requires entities to provide sufficient information to enable users to understand how the transition to IFRSs affected previous annual and interim figures.

IFRS 1.32 states that a first-time adopter shall satisfy the following requirements in addition to those in IAS 34:

- “(a) Each such interim financial report shall, if the entity presented an interim financial report for the comparable interim period of the immediately preceding financial year, include:
- (i) a reconciliation of its equity in accordance with previous GAAP at the end of that comparable interim period to its equity under IFRSs at that date; and
 - (ii) a reconciliation to its total comprehensive income in accordance with IFRSs for that comparable interim period (current and year to date). The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for that period or, if an entity did not report such a total, profit or loss in accordance with previous GAAP.
- (b) In addition to the reconciliations required by (a), an entity's first interim financial report in accordance with IAS 34 for part of the period covered by its first IFRS financial statements shall include the reconciliations described in paragraph 24(a) and (b) (supplemented by the details required by paragraphs 25 and 26) or a cross-reference to another published document that includes these reconciliations.”

The reconciliations required by IFRS 1.32(a) are only presented if the first-time adopter presented an interim financial report for the comparable interim period of the immediately preceding financial year (under previous GAAP). It is not sufficient to present the reconciliations in (a) only in the first quarter (for example). The reconciliations are required in each interim financial report presented during the first annual period under IFRSs.

The reconciliations required by IFRS 1.32(b) are presented only in the first interim financial report. This may be satisfied by including the information directly in the interim financial report, or alternatively by cross-reference to another published document. In the next (say) quarterly interim report the first-time adopter is not required to re-present these reconciliations (but may choose to do so, for example by way of cross-referring to the first interim financial report).

The various requirements can be illustrated by the following example below:

Example D.4: Interim financial reporting

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. It presents only one full comparative period and its date of transition to IFRSs is 1 January 2011. Its first interim financial report under IAS 34 is for the quarter ended 31 March 2012. It is required by its stock exchange to provide interim reports each quarter. Entity A prepared previous GAAP annual financial statements for the year ended 31 December 2011 and quarterly reports under previous GAAP.

Application of paragraph 32(a)

In each quarterly interim financial report for 2012, entity A includes reconciliations of:

- (a) equity under previous GAAP at the end of the comparable quarter of 2011 to its equity under IFRSs at that date; and
- (b) total comprehensive income (or, if it did not report such a total, profit or loss) under previous GAAP for the comparable quarter of 2011 (current and year-to-date) to its total comprehensive income under IFRSs (current and year-to-date). For the quarter ended 31 March 2012 the current period amounts and year-to-date totals are the same. For the period ended 30 June 2012 two reconciliations are required (current and year-to-date).

Application of paragraph 32(b)

In addition to the reconciliations required above and the disclosures required by IAS 34, entity A's interim financial report for the first quarter of 2012 includes reconciliations (or alternatively a cross-reference to another published document that includes these reconciliations) of:

- (a) its equity under previous GAAP at 1 January 2011 (the date of transition) and 31 December 2011 (the end of the latest period presented under previous GAAP) to its equity under IFRSs at those dates; and
- (b) its total comprehensive income (or, if it did not report such a total, profit or loss) for the year ended 31 December 2011 under previous GAAP to its total comprehensive income for 2011 under IFRSs (a reconciliation of the last year presented under previous GAAP).

In the next quarterly interim reports the entity may choose, but is not required, to present the reconciliations in IFRS 1.32(b). If it chooses to present them it can do it by cross-reference to the first interim report.

Statement of cash flows

Entity A also explains the material adjustments to the statement of cash flows, as required by IFRS 1.25.

Sufficient detail must be given to enable users to understand the transition to IFRSs (IFRS 1.25). We consider that the same level of detail applies for interim reports as for the first IFRS annual financial statements.

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'. Therefore, 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 must disclose that information or include a cross-reference to another published document that includes it (IFRS 1.33). In practice, disclosures will vary substantially between entities, and judgement is required to establish whether additional disclosures are required in other areas.

Interim financial reports in the first IFRS annual period should in our view include sufficient information on IFRS accounting policies to meet the general requirement on 'information material to an understanding' in IFRS 1.33 (unless this information was disclosed in the previous year's local GAAP financial statements or another published document, and a cross-reference is provided).

Section B2.3 includes a discussion of the accounting policies to be applied in interim financial reports.

Appendix I. Current effective exemptions

This Appendix provides an overview of current IFRS 1 exemptions.

The tables set out (for an entity whose financial year ends on 31 December) the exemptions in effect for annual periods ending on 31 December 2011, 31 December 2012 and 31 December 2013. Where an exemption is not effective, early application may be permitted. First-time adopters whose reporting date is not 31 December should look to the specific dates in IFRS 1.

Future amendments to IFRS 1

Readers should note that the tables below reflect IFRS 1's requirements at the date of release of this guide (October 2012). Amendments to IFRS 1 and other IFRSs issued after the publication of the guide will also need to be considered by first-time adopters.

1 Mandatory exemptions

Mandatory exemptions from full retrospective application

	Effective date/early application permitted	Effective at the end of the reporting period:		
		31 Dec 2011	31 Dec 2012	31 Dec 2013
Derecognition of financial assets and financial liabilities	n/a	Yes	Yes	Yes
Hedge accounting	n/a	Yes	Yes	Yes
Estimates	n/a	Yes	Yes	Yes
Consolidation and non-controlling interests	n/a	Yes	Yes	Yes
Government loans	n/a	No	No	Yes

Yes: The exemption is effective at the end of the reporting period and must be applied.

No: The exemption is not effective, but may be available for early application

2 Optional exemptions

Optional exemptions from full retrospective application

	Effective date/early application permitted	Effective at the end of the reporting period:		
		31 Dec 2011	31 Dec 2012	31 Dec 2013
Business combinations	n/a	Yes	Yes	Yes
Deemed cost	n/a	Yes	Yes	Yes
Employee benefits (note 1)	n/a	Yes	Yes	n/a
Cumulative translation differences	n/a	Yes	Yes	Yes
Compound financial instruments	n/a	Yes	Yes	Yes
Assets and liabilities of subsidiaries, associates and joint ventures	n/a	Yes	Yes	Yes
Designation of previously recognised financial instruments	n/a	Yes	Yes	Yes
Share-based payment transactions	n/a	Yes	Yes	Yes
Insurance contracts	n/a	Yes	Yes	Yes
Decommissioning liabilities included in the cost of property, plant and equipment	n/a	Yes	Yes	Yes
Leases	n/a	Yes	Yes	Yes
Fair value measurement of financial assets or financial liabilities at initial recognition	n/a	Yes	Yes	Yes
Service concession arrangements	n/a	Yes	Yes	Yes
Borrowing costs	Reporting periods beginning on or after 1 January 2013/Yes	No	No	Yes
Investments in subsidiaries, joint ventures and associates	n/a	Yes	Yes	Yes
Transfers of assets from customers	n/a	Yes	Yes	Yes
Extinguishing financial liabilities with equity instruments	n/a	Yes	Yes	Yes
Stripping costs in the production phase of a surface mine	Reporting periods beginning on or after 1 January 2013/Yes	No	No	Yes
Severe hyperinflation	Reporting periods beginning on or after 1 July 2011/Yes	No	Yes	Yes
Joint arrangements	Reporting periods beginning on or after 1 January 2013/Yes	No	No	Yes

Yes: The exemption is effective at the end of the reporting period and can be applied (optional).

No: The exemption is not effective, but may be available for early application

Note 1: No exemption is allowed if the entity elects to adopt the amended version of IAS 19. See section C2.4 above and the optional short term exemption in the table below.

3 Optional short term exemptions

Optional short term exemptions from full retrospective application

	Effective date/early application permitted	Effective at the end of the reporting period:		
		31 Dec 2011	31 Dec 2012	31 Dec 2013
Disclosures of financial assets (note 1)	n/a	Yes	Yes	Yes
Disclosures about transfers of financial assets (note 2)	Reporting periods beginning on or after 1 July 2011/Yes	No	Yes	n/a
Employee benefits (note 3)	Reporting periods beginning on or after 1 January 2013/Yes	No	No	Yes

Yes: The exemption is effective at the end of the reporting period and can be applied (optional).

No: The exemption is not effective, but may be available for early application.

Note 1: IFRS 7 was amended in March 2009 to improve disclosures about (i) how entities determined the fair value of their financial instruments; and (ii) liquidity risk. Since then IFRS 13 'Fair Value Measurement' has been published which contains disclosures that supersede those referred to in (i). A first-time adopter is not required to provide the disclosures required by the amendments to IFRS 7 for comparative period that ended before 31 December 2009. Given the date prescribed, this relief is now unlikely to be relevant.

Note 2: IFRS 7 was amended in October 2010 in order help users of financial statements evaluate the risk exposures relating to more complex transfers of financial assets and the effect of those risks on an entity's financial position. The amendments added paragraph 42A-42H, which require disclosures about:

- transfers of financial assets that are not derecognised in their entirety: the entity should disclose information that enables users to understand the relationship between the financial assets that are not derecognised and the associated liabilities
- transfers of financial assets that are derecognised in their entirety: the entity should disclose information that enables users to evaluate the nature of the entity's continuing involvement in the derecognised financial assets and the risks associated with it.

The transitional provisions to the amendments to IFRS 7 state that these disclosures are not required for periods that begin before the date of the initial application of the amendments. A first-time adopter may elect to use these transitional provisions.

Note 3: IAS 19R.145 requires an entity to disclose:

- a sensitivity analysis for each significant actuarial assumption used to determine the present value of the defined benefit obligation
- the methods and assumptions used in preparing the 'sensitivity analysis' and the limitation of those methods and changes from the previous period in those methods and assumptions and the reasons for that change.

A first-time adopter that elects to apply IAS 19R is not required to provide comparative information for periods beginning before 1 January 2014.

Appendix II. Selected application issues

1 Introduction

This appendix provides additional application guidance on a number of issues that give rise to frequent questions in practice.

Guidance is included on the following issues:

- Intangible assets – capitalisation of development costs
- Leases
- Financial instruments
- Hedge accounting
- Income taxes
- Business combinations
- Venture capital organisations and investments in associates
- Pre-transition share-based payments.

2 Intangible assets – capitalisation of development costs

This discussion is in the context of internally developed intangible assets rather than items acquired in a business combination (see paragraph 7.2 of this appendix) or through separate acquisition.

Only intangible assets that qualify for recognition under IFRSs can be recognised in the opening statement of financial position. Intangible assets that do not meet the criteria for recognition under IAS 38 'Intangible Assets' (IAS 38) are excluded.

IAS 38.57 – 64 set out the conditions for the recognition of internally generated intangible assets. That standard also requires that an entity capitalises the costs of creating an intangible asset prospectively from the date when the recognition criteria are met. IAS 38 prohibits the entity from capitalising incurred costs retrospectively before the date the entity concludes that the recognition criteria are met. If an internally generated intangible asset qualifies for recognition at the date of transition to IFRSs, the first-time adopter recognises only the incurred expenses after the date the recognition criteria were met. 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 later date. Recognition of internally generated intangible assets may be required, even if previous GAAP did not permit recognition (see IFRS 1.IG46 – 47 for more detail).

If the cost method is applied the first-time adopter adjusts accumulated amortisation if this is necessary because the amortisation methods under previous GAAP are not appropriate under IAS 38 (IFRS 1.IG51). If the revaluation method is applied, the first-time adopter performs a revaluation at the date of transition if the carrying amount of the asset differs from the fair value at that date (IAS 38.75).

3 Leases

The requirement for retrospective application implies that a first-time adopter classifies leases as operating leases or finance leases at the date of transition on the basis of the circumstances existing at inception of the lease (IFRS 1.IG14).

However, where the provisions of the lease are changed after its inception, other than by renewal of the lease, and these new terms and conditions would have resulted in a different classification had these been in effect at the inception of the lease, IFRS1.IG14 states that the new terms and conditions are considered in determining the correct classification (ie lease classification is based on the terms in force at the date of the modification) and the revised agreement is considered a new agreement. If the terms and conditions are changed after the date of transition the normal requirements in IAS 17 'Leases' apply.

4 Financial instruments

Accounting for financial instruments in accordance with IFRSs is complex and is a challenging area for many first-time adopters. For example, the requirements of IAS 39 'Financial Instruments: Recognition and Measurement' (IAS 39) on recognition, measurement, derecognition, embedded derivatives, impairment and hedge accounting frequently differ from local or previous GAAP.

Initially the first-time adopter should identify all financial instruments that are within the scope of IAS 32 'Financial Instruments: Presentation' (IAS 32) and IAS 39. The first-time adopter then applies the requirements in those standards to those financial instruments. First-time adopters should also assess the disclosure requirements in IFRS 7 'Financial Instruments: Disclosures' (IFRS 7) at an early stage in their conversion process.

4.1 Recognition

A first-time adopter recognises and measures all financial assets and liabilities in its opening statement of financial position in accordance with IAS 39, with the exception of the specific exemptions for:

- derecognition of some financial assets and liabilities under previous GAAP (IFRS 1.B2 – 3). In accordance with this exemption the entity does not recognise non-derivative financial assets or liabilities derecognised under previous GAAP before the date of transition, to which the first-time adopter chooses not to apply IFRS 1.B3, unless they qualify for recognition as a result of a later event (see discussion in section C3.1)
- the hedge accounting requirements on first-time adoption of IFRSs (IFRS 1.B4 – 6).

A first-time adopter does not recognise in its opening statement of financial position financial assets or financial liabilities that qualified for derecognition under IAS 39 prior to the date of transition (IFRS 1.IG53 – 54).

4.2 Measurement

4.2.1 Categories

IAS 39 requires that each financial asset and liability within its scope is classified into one of a number of specified 'categories' at initial recognition. These categories apply equally to a first-time adopter in preparing an opening statement of financial position and first IFRS financial statements. First-time adopters should ensure they identify the correct classification or designation in accordance with IAS 39's definitions and conditions for designation. This is important both in the context of measuring those instruments and because there are various constraints on subsequent transfers between IAS 39's categories.

Designation into the held-to-maturity category is optional under IAS 39 for financial assets that have certain characteristics and which meet specified conditions. Such assets are measured at amortised cost (less impairment). The implementation guidance to IFRS 1 states that designation is applied based on the first-time adopter's intention and ability at the date of transition. Further, it states that sales or reclassifications of held-to-maturity investments that have occurred before the date of transition, do not trigger the prohibition of classifying financial assets as held-to-maturity (IFRS 1.IG56(a)). In other words the IAS 39 tainting rules are applied prospectively from the date of transition.

IAS 39.9 sets out the requirements for classification of a financial asset within loans and receivables. Loans and receivables are also measured at amortised cost (less impairment). The IAS 39.9 requirements include the intention not to sell the financial asset immediately or in the near term. IFRS 1 clarifies that when a first-time adopter classifies a financial asset as loans and receivables, the classification is based on the circumstances when the financial asset first satisfied the recognition criteria in IAS 39 (IFRS 1.IG56(b)).

IAS 39.9 requires that derivative financial assets and derivative financial liabilities are included in the held for trading category (except for a derivative that is a financial guarantee contract or is a designated and effective hedging instrument). All such derivatives are measured at fair value through profit or loss.

The first-time adopter classifies non-derivative financial assets and non-derivative financial liabilities as held for trading (measured at fair value through profit or loss) at the date of transition, when the asset or liability was:

- acquired or incurred principally for the purpose of selling or repurchasing it in the near term (IFRS 1.IG56(d)(i))
- at the date of transition to IFRSs, part of a portfolio of identified financial instruments that were managed together and for which there was evidence of a recent actual pattern of short-term profit-taking (IFRS 1.IG56(d)(ii)).

For non-derivative financial assets and non-derivative financial liabilities that are not held for trading, IAS 39 includes what is commonly referred to as a 'fair value option'. The fair value option allows entities to designate, at initial recognition, financial assets and liabilities in the fair value through profit or loss category. A first-time adopter is permitted to designate a non-derivative financial asset or liability at fair value through profit or loss at the date of transition if the criteria in IAS 39 are met at the date of transition to IFRSs (IFRS 1.D19). In other words, the first-time adopter is not required to have made this designation on initial recognition if that date was prior to the date of transition. This exemption from normal IFRSs rules is available only for an entity that presents its first IFRS financial statements for an annual period beginning on or after 1 January 2006 (IFRS 1.IG56(d)(iii)).¹³

Available-for-sale financial assets are those non-derivative financial assets designated as available-for-sale or those that are not in any of the other categories of financial assets (IFRS 1.IG56(e)).

Non-derivative financial liabilities that are not measured at fair value through profit or loss (held for trading or designated at fair value through profit or loss) are measured at amortised cost.

4.2.2 Financial instruments measured at amortised cost in opening statement of financial position

If classification of a financial asset or a financial liability requires measurement at amortised cost in the opening statement of financial position, a first-time adopter determines cost on the basis of circumstances existing when the assets and liabilities first qualified for recognition in accordance with IAS 39 (IFRS 1.IG57).

This does not apply, however, if the financial asset or financial liability was acquired or assumed in a past business combination. In this case, the requirements in Appendix C apply (IFRS 1.IG57). This requires that their carrying amount under previous GAAP immediately following the business combination is their deemed cost under IFRSs at that date (IFRS 1.C4(e)).

Determining amortised cost involves using the effective interest method. IFRS 1 does not include any exemptions from IAS 39's normal requirements in this area. Accordingly, first-time adopters should determine the original effective interest rate based on expected cash flows, expected life and carrying amount on initial recognition, all determined in accordance with IAS 39. Additional considerations apply to some specific types of financial assets and liabilities, such as floating rate assets and liabilities and contracts for which expected life and/or cash flows cannot be reliably estimated.

¹³ Further requirements are stated in IFRS 1.IG.56(d)(iv) for entities that present their first IFRS financial statements for an annual period beginning before 1 January 2006.

4.2.3 Estimates of impairment at the date of transition

Estimates of loan impairments at the date of transition must be consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies). If, however, there is objective evidence that these estimates were in error, then the estimates shall be adjusted for that fact. This is consistent with the general requirements for estimates in IFRS 1.14 (see section C3.3). The impact of later revisions to those estimates that reflect circumstances after the date of transition shall be reflected, in accordance with IAS 39's requirements for impairment losses, in the period in which the entity makes the revisions either as an additional impairment loss or as a reversal of impairment if IAS 39's criteria are met (IFRS 1.IG58).

4.2.4 Transition adjustments

A first-time adopter treats an adjustment to the carrying amount of a financial asset or financial liability as a transition adjustment to be recognised in the opening balance of retained earnings (or another appropriate part of equity) at the date of transition to IFRSs only to the extent that it results from adopting IAS 39 (IFRS 1.IG58A). IAS 8 applies to adjustments resulting from changes in estimates. If an entity is unable to determine whether a particular portion of an adjustment is a transition adjustment or a change in estimate, it treats that portion as a change in accounting estimate under IAS 8, with appropriate disclosures in accordance with IAS 8.32 – 40 (IFRS 1.IG58B).

A first-time adopter may, under its previous GAAP, have measured investments at fair value and recognised the revaluation gain outside profit or loss. If an investment is classified as at fair value through profit or loss, the pre-IAS 39 revaluation gain that had been recognised outside profit or loss is reclassified into retained earnings on initial application of IAS 39. Revaluation gains on financial assets classified as available-for-sale are reclassified into a separate component of equity (IFRS 1.IG59).

4.3 Presentation of financial instruments as liabilities or equity

Many first-time adopters will find that there are differences between previous GAAP and IFRSs in relation to the classification of issued financial instruments as financial liabilities or as equity. For example, an issued financial instrument may be classified as equity under previous GAAP, whereas IFRSs classify the instrument as a financial liability. A change in classification may have a significant effect on the reported financial position and financial results.

A first-time adopter applies the criteria in IAS 32 to classify issued financial instruments (or components of instruments where applicable) as either financial liabilities or equity instruments. The classification is determined in accordance with the substance of the contractual arrangement when the instrument first satisfied the recognition criteria in IAS 32. Events after that date are not relevant for the presentation, except for changes to the terms of the instruments (IFRS 1.IG35).

Financial instruments that are classified as equity are outside the scope of IAS 39.

4.4 Embedded derivatives

IAS 39's requirements on 'embedded derivatives' are complex and challenging for many first-time adopters. In summary, an embedded derivative is a component of a 'hybrid' (or combined) instrument that (i) also includes a non-derivative host contract; and (ii) would meet the definition of a derivative financial instrument if it were a free-standing contract. A common example is an embedded option to convert a debt instrument into equity of the issuer (a convertible debt instrument from the perspective of the holder).

IAS 39 requires the embedded derivative to be separated from the host contract if certain conditions are met (broadly, when its economic characteristics are not 'closely related' to those of the non-derivative host contract). Once separated, an embedded derivative is accounted for as at fair value through profit or loss. Separation involves identifying the stated or implied terms of the embedded derivative and can itself be a complex task.

IFRS 1 does not provide any exemption in this area, even though retrospective application can be difficult and costly. Therefore, first-time adopters need to consider separation of embedded derivatives. In accordance with IAS 39 the initial carrying amounts of the embedded derivative and host contract reflect circumstances at the date when the instrument first satisfies the recognition criteria in IAS 39. Where the entity cannot determine the initial carrying amounts reliably it treats the entire instrument as held for trading and accounts for it as at fair value through profit or loss (IFRS 1.IG55).

IFRS 1's requirements on compound financial instruments (from the perspective of the issuer) are discussed in section C2.6.

5 Hedge accounting

Hedge accounting is an optional accounting treatment that is available to entities that are able to comply with IAS 39's strict criteria, including designation, documentation and effectiveness testing. An entity that applies hedge accounting treats some financial instruments differently to the normal IAS 39 requirements. IAS 39 therefore contains detailed rules to limit the use of hedge accounting to appropriate circumstances.

Retrospective application of the requirements in IAS 39 could lead to selective designation of some hedges in order to report a particular result, for example, by not designating a derivative as a hedging instrument if it has yielded a fair value gain. Consequently, a prohibition on retrospective application is included in IFRS 1 (described in section C3.2). However, the practical application of these rules is complex.

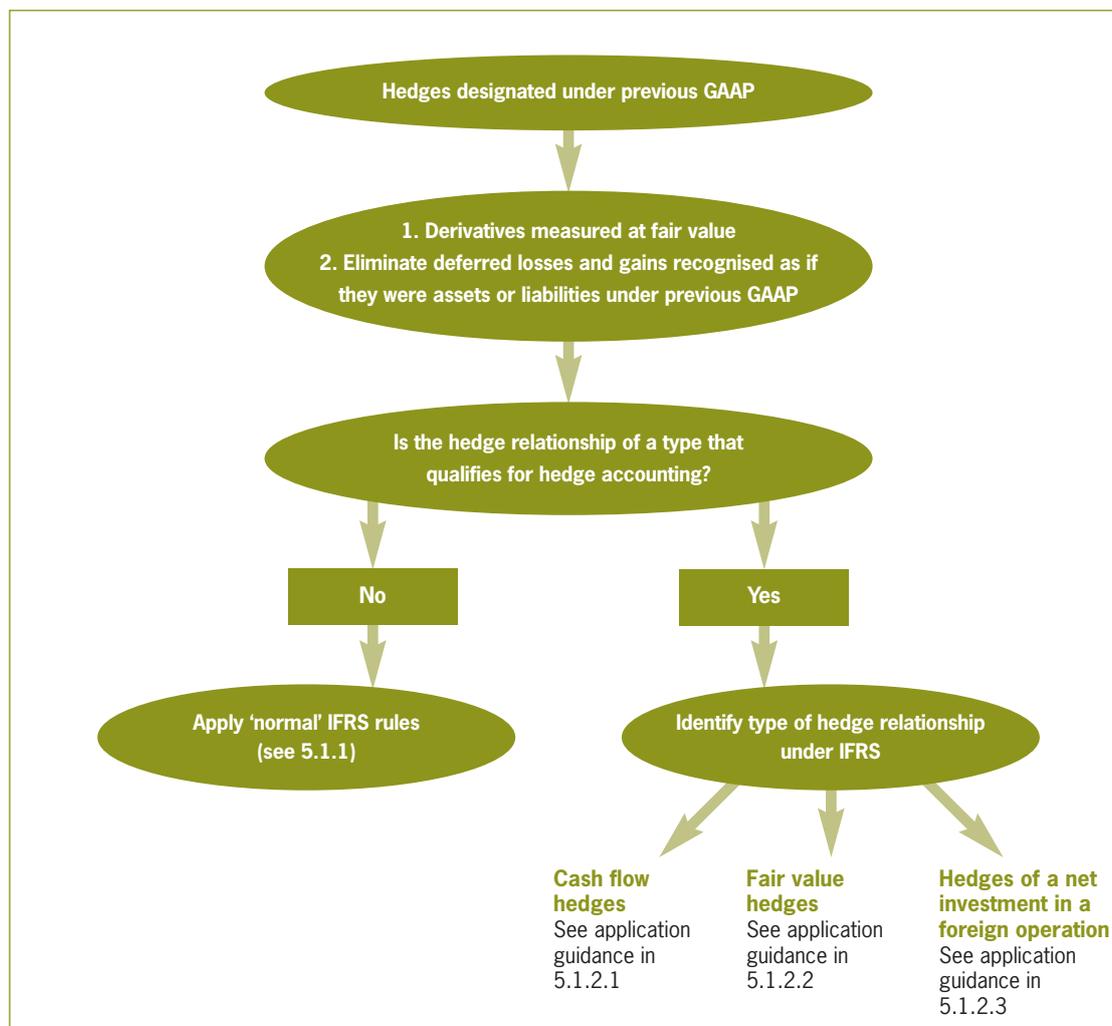
For relationships designated as hedges under previous GAAP, it is essential for a first-time adopter to consider: (i) how the hedge should be reflected in the opening statement of financial position; and (ii) how the hedge is accounted for after the date of transition. These issues are dealt with in the following paragraphs for each of the types of hedging relationship in IAS 39.

5.1 Reflecting hedges in the opening statement of financial position

A first-time adopter may have adopted a form of hedge accounting under its previous GAAP. On transition to IFRSs the hedging relationship may need to be reflected in the opening statement of financial position. The accounting in the opening statement of financial position is the starting point for subsequent accounting under IFRSs.

In accordance with IFRS 1.B5 a first-time adopter does not in its opening statement of financial position reflect an identified hedging relationship of a type that does not qualify for hedge accounting under IAS 39 (except for certain hedging relationships in which the hedged item is a net position). For example, the hedged item under previous GAAP might be a portion of a non-financial asset. This would not be permitted as a hedged item under IAS 39. See paragraph 5.1.1 below for more guidance in this situation.

In its opening statement of financial position, the first-time adopter does not reflect hedging relationships that were designated as such under previous GAAP and which are of a type that qualify for hedge accounting under IAS 39. The treatment in the opening statement of financial position is summarised in the following flowchart, and is described in turn below.



5.1.1 Hedging relationships of a type that do not qualify for hedge accounting

Examples of hedging relationships that do not qualify for hedge accounting include hedges where the hedging instrument is a non-derivative financial asset or liability (other than for a hedge of foreign currency risk) or the entity's own equity. As another example, a held-to-maturity investment cannot be a hedged item with respect to interest rate risk (IAS 39.79). These are examples of what IFRS 1.B5 refers to as hedging relationships of a type that do not qualify for hedge accounting under IAS 39. Assessment of the type of the hedging relationship is not the same as assessment of whether IAS 39's conditions for hedge accounting are met.

Where the hedging relationships do not qualify for hedge accounting under IAS 39, the transactions are measured as prescribed by normal IFRSs rules. This has the following consequences in the opening statement of financial position:

- derivative financial instruments are measured at fair value through profit or loss, ie they are in effect treated as derivatives held for trading
- the designated hedged item is measured in accordance with IFRSs requirements (including the effect of IFRS 1 exemptions if applicable).

IFRS 1.B5 provides one exemption to this rule. 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 under IFRSs provided that it does so no later than the date of transition to IFRSs.

5.1.2 Hedging relationships of a type that qualify for hedge accounting under IAS 39

The first-time adopter may have designated a hedging relationship under previous GAAP that is of a type which does qualify for hedge accounting under IAS 39. This hedging relationship is reflected in the opening statement of financial position by applying the rules for hedge accounting in IAS 39. The accounting in the opening statement of financial position is therefore dependent on the type of hedging relationship (cash flow hedge, fair value hedge or hedge of a net investment in a foreign operation). The requirements are best examined by considering each type of hedging relationship separately. It should be noted that in these circumstances the way in which the hedging relationship is reflected in the opening statement of financial position is generally the same whether or not IAS 39's conditions for hedge accounting have been met. However, meeting or not meeting the IAS 39 conditions does affect the subsequent accounting (see paragraph 5.2 below).

5.1.2.1 Cash flow hedges of a type that qualify for hedge accounting under IAS 39

For cash flow hedges identified under previous GAAP that qualify for hedge accounting under IAS 39, IFRS 1 requires that the first-time adopter reflects the hedging relationship in the opening statement of financial position, if and only if the hedged forecast transaction is still expected to occur. If the hedged forecast transaction is not expected to occur at the date of transition, the hedging instrument (derivative) is included in the opening statement of financial position at its fair value and the cumulative gain or loss is included in opening retained earnings (ie the previous GAAP hedging relationship is not reflected as a hedge at the date of transition).

If the hedged forecast transaction is still expected to occur the hedging instrument (normally a derivative) is recognised in the opening statement of financial position in a similar manner to an effective cash flow hedge under IAS 39. The hedging instrument is measured at fair value in the opening statement of financial position (like all derivatives). The cumulative gain or loss on the derivative is included in the cash flow hedging reserve to the extent that the hedged transaction has not yet affected profit or loss. The portion that has affected profit or loss is recognised in opening retained earnings.

Under IAS 39.88(c) a forecast transaction that is subject to a hedge must be highly probable when the hedge is designated. If, at the date of transition to IFRSs, the hedged forecast transaction is not highly probable but is still expected to occur, the deferred gain or loss is recognised in equity as a cash-flow hedging reserve. The amount recognised in the cash-flow hedging reserve is not reduced by any ineffectiveness up to the date of transition. This cumulative gain or loss remains in equity until (a) the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, (b) the forecast transaction affects profit or loss or (c) subsequently circumstances change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss is reclassified from equity to profit or loss (IFRS 1.IG60B).

Where forecast transactions are still highly probable at the date of transition, consider the following example which illustrates the requirements for a cash flow hedge:

Example 1: Cash flow hedge of a forecast transaction – opening statement of financial position

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. Its date of transition to IFRSs is 1 January 2011.

In 2010 entity A designated a cash flow hedging relationship under previous GAAP over currency risk in a highly probable sale of goods for foreign currency (FC) 100. The hedging relationship qualifies as a cash flow hedge of a highly probable forecast transaction under IAS 39. Entity A entered into a forward contract to sell FC 100 and buy local currency (LC) at a forward rate of 0.9 LC/1 FC.

Under its previous GAAP, entity A was not required to recognise the forward contract. The forecast transaction remains highly probable at the date of transition to IFRSs (1 January 2011).

Application of requirements

The forward contract is a derivative. Entity A measures the derivative in its opening statement of financial position at fair value. The entire cumulative gain or loss is recognised in the cash flow hedging reserve at 1 January 2011 regardless of effectiveness up to that date (this will represent the full amount since the transaction has not yet affected profit or loss in this case).

This would also be the case if the forecast transaction was not highly probable but was still expected to occur at the date of transition (IFRS 1.IG60B).

Subsequent measurement is addressed in Example 3 below

5.1.2.2 Fair value hedges of a type that qualify for hedge accounting under IAS 39

IFRS 1 requires that the first-time adopter restates the hedged item in the opening statement of financial position. The hedging instrument is restated to its fair value in the opening statement of financial position with any corresponding adjustment to opening retained earnings (this represents unrecognised gains and losses for previous years).

IFRS 1 requires the hedged item to be adjusted in a manner that is similar (but not quite identical) to the entries that would have been made had the entity always applied IAS 39's fair value hedge accounting rules. The adjustment to the hedged item is 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, under previous GAAP, was either (i) not recognised or (ii) deferred in the statement of financial position as an asset or liability (IFRS 1.IG60A).

To illustrate, consider the following example:

Example 2: Fair value hedge in the opening statement of financial position

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. Its date of transition to IFRSs is 1 January 2011.

In 2009 Entity A took out a loan of CU 100 from a bank. The loan is repayable in 2015, has a fixed interest rate and interest is paid every 4 months. Subsequently entity A decided to alter its interest exposure by entering into a pay floating-receive fixed interest rate swap with maturity in 2015 (same date as loan).

Under previous GAAP this arrangement was designated as a hedging relationship. Previous GAAP did not require recognition of the hedging instrument. The settlements on the interest rate swap were periodically accrued and recognised as an adjustment to the interest expense on the loan.

Application of requirements

The hedging relationship qualifies for hedge accounting as a fair value hedge under IAS 39. Entity A recognises the following in the opening statement of financial position:

- The positive fair value of the hedging instrument is CU 10 at 1 January 2011. Under previous GAAP the carrying amount was CU Nil. Entity A recognises the derivative at CU 10 with a corresponding entry to opening retained earnings
- The loan is recognised at amortised cost under IFRSs. Its carrying amount at 1 January 2011 is CU 95. The cumulative change in the fair value of the loan attributable to the hedged risk was CU 9 at 1 January 2011. Entity A adjusts the carrying amount of the loan by the lower of that change and the change in the fair value of the hedging instrument attributable to the hedged risk, the carrying amount of the loan is therefore adjusted by CU 9 so that the loan's carrying amount is CU 104 at 1 January 2011. The corresponding entry is to opening retained earnings.

5.1.2.3 Net investment hedges

Net investment hedges are treated similarly to cash flow hedges under IAS 39. In summary, foreign exchange differences on the hedging instrument used to hedge a net investment are presented in other comprehensive income. These foreign exchange differences are reclassified to profit or loss on the disposal or partial disposal of the investment.

Many first-time adopters use the exemption to reset cumulative translation differences on foreign operations to zero at the date of transition to IFRSs (IFRS 1.D13). In our view, if a net investment hedge was designated before the date of transition, the accounting treatment will depend on whether the first-time adopter uses this exemption.

Where a first-time adopter uses the exemption to reset cumulative translation differences on foreign operations to zero at its date of transition, the question arises as to whether the first-time adopter recognises a separate hedging reserve for pre-transition gains and losses on hedging instruments used to hedge net investments in foreign operations. If recognised this hedging reserve would be reclassified to profit or loss on disposal of the foreign operation. A mismatch would then occur on subsequent disposal of the foreign operation as pre-transition cumulative translation differences on the foreign operations would not be recognised in profit or loss while the related pre-transition gains and losses on the hedging instruments would be. Therefore, in our view the pre-transition gains and losses on a hedging instrument used to hedge net investments in foreign operations recognised in equity should be reclassified to opening retained earnings at the date of transition (ie resetting the net investment hedging reserve to zero). Gains and losses on the hedging instrument after the date of transition will be recognised in a hedging reserve if the hedge meets and continues to meet IAS 39's conditions. The result is that only post-transition translation differences on the hedging instrument will be reclassified to profit or loss on subsequent disposal of the foreign operation, which in our view is consistent with the principle in IFRS 1.D13.

Where a first-time adopter does not use the exemption to reset cumulative translation differences at the date of transition, the net investment hedge should be reflected in the opening statement of financial position in accordance with IAS 39.102 and IFRIC 16 'Hedges of a Net Investment in a Foreign Operation'.

5.2 Subsequent accounting after the date of transition

The starting point for subsequent accounting under IFRSs is the opening statement of financial position. How does the first-time adopter account for the hedging relationship after the date of transition?

In accordance with IFRS 1.IG60 the designation and the documentation of a hedging relationship must be completed on or before the date of transition if the hedging relationship is to qualify for hedge accounting under IFRSs from that date. Thus, hedge accounting is applied prospectively only from the date that the hedging relationship is fully designated and documented.

In effect, this means that first-time adopters who wish to continue with hedge accounting need to have adequate documentation in place at the date of transition. First-time adopters may find the documentation requirements more extensive compared to previous GAAP – early planning is necessary. The requirements are discussed in turn for each type of hedging relationship below.

5.2.1 Cash flow hedges

The first-time adopter cannot continue hedge accounting if the requirements in IAS 39 are not met at the date of transition. If the first-time adopter concludes that the IAS 39 requirements are not met, it applies IAS 39.101 to discontinue cash flow hedge accounting prospectively from the date of transition (IFRS 1.B6). Should the entity conclude that the cash flow hedge accounting requirements are met, the first-time adopter applies IAS 39 to the hedging relationship from the date of transition.

In summary, prospective discontinuance of cash flow hedge accounting means that gains or losses on the hedging instrument are recognised in profit or loss:

- when the forecast transaction that has been hedged affects profit or loss or
- when the forecast transaction is no longer expected to occur.

The requirements for subsequent accounting are considered in the following example illustrating a cash flow hedge of a forecast transaction:

Example 3: Cash flow hedge of a forecast transaction – accounting after the date of transition

Background

The situation is as described in Example 1 above. The forward contract was recognised in the opening statement of financial position at fair value and the gain or loss was recognised in the cash flow hedging reserve in equity.

Application of requirements

Scenario 1– the forecast transaction is still highly probable and all other IAS 39 requirements are met from 1 January 2011

From 1 January 2011 the portion of gain or loss on the forward contract that is determined to be an effective hedge is then recognised in the cash flow hedging reserve. The cumulative gains or losses included in the cash flow hedging reserve remain there until the forecast transaction affects profit or loss or results in the recognition of a non-financial asset or liability.

Scenario 2– the forecast transaction is no longer highly probable but still expected to occur

The cumulative gains or losses up to the date that the forecast transaction ceases to be highly probable are recognised in the cash flow hedging reserve until the forecast transaction affects profit or loss or subsequently results in the recognition of a non-financial asset or liability. Subsequent gains and losses on the forward contract are recognised in profit or loss.

Scenario 3– the forecast transaction is no longer expected to occur

The cumulative gain or loss recognised in the cash flow hedging reserve up to 1 January 2011 is reclassified from equity to profit or loss. Subsequent gains and losses on the forward contract are also recognised in profit or loss.

5.2.2 Fair value hedges

If the first-time adopter concludes that the IAS 39 requirements are not met at the date of transition it applies IAS 39.91 to discontinue fair value hedge accounting prospectively (IFRS 1.B6). Should the entity conclude that the fair value hedge accounting requirements are met, the first-time adopter applies IAS 39 hedge accounting rules from the date of transition.

The discontinuation of a fair value hedge means that the hedged item is no longer adjusted for gains and losses attributed to the hedged risk. The requirements are described further in IAS 39.92. To illustrate the requirements for subsequent measurement, consider the following example:

Example 4: Fair value hedge – subsequent measurement

Background

The situation is as described in Example 2 above. The interest rate swap was recognised in the opening statement of financial position and the hedged item was adjusted.

Application of requirements

Scenario 1– hedge accounting requirements are not met at 1 January 2011

Entity A discontinues hedge accounting prospectively from the 1 January 2011 in accordance with IAS 39.91.

Scenario 2– hedge accounting requirements are met at 1 January 2011 and thereafter

Entity A applies fair value hedge accounting prospectively from the 1 January 2011 in accordance with IAS 39.

Scenario 3– hedge accounting requirements met after 1 January 2011

The documentation was prepared after the 1 January 2011, for example on 1 August 2011. As a result, hedge accounting can be applied prospectively with effect from 1 August 2011. For the period 1 January 2011 (date of transition) to 31 July 2011, hedge accounting cannot be applied. Consequently, at the date of transition to IFRSs, entity A discontinues hedge accounting prospectively in accordance with IAS 39.91.

5.2.2.1 Net investment hedges

The principle for cash flow hedges applies equally to net investment hedges. The designation and documentation of a hedging relationship must be completed on or before the date of transition to IFRSs if the hedging relationship is to qualify for hedge accounting from that date (IFRS 1.IG60). Hedge accounting can be applied prospectively only from the date that the hedging relationship is fully designated and documented. Therefore, if the net investment hedge does not qualify for hedge accounting at the date of transition it is discontinued prospectively. If the net investment hedge qualifies for hedge accounting, the first-time adopter accounts for the hedge in accordance with the requirements in IAS 39.102.

6 Income taxes

Deferred taxes shall be reflected in the first IFRS financial statements using the requirements in IAS 12 'Income Taxes' (IAS 12).

In the opening statement of financial position deferred tax is recognised as appropriate on temporary differences between the carrying amount of assets and liabilities and their tax bases (IFRS 1.IG5). Under IAS 12, an entity is required to use the tax rates and laws that have been enacted or substantially enacted at the end of the reporting period. IFRS 1 notes that an entity shall account for the effects of changes in tax laws and tax rates when those changes are enacted or substantially enacted (IFRS 1.IG6). This is consistent with the IFRS 1 requirements for estimates, ie estimates shall be consistent with those under previous GAAP, unless there is objective evidence that those estimates were in error. For example, a first-time adopter with a reporting date of 31 December 2012 would not recognise a change in tax rates occurring in September 2012 in its opening statement of financial position (1 January 2011). The change in tax rates will be reflected in the year ended 31 December 2012.

6.1 IAS 12 initial recognition exemption

The so-called 'initial recognition exemption' in IAS 12 prohibits recognition of deferred tax assets or liabilities on temporary differences that arise on initial recognition of an asset or liability in a transaction, other than a business combination, that does not affect accounting or taxable profit (IAS 12.15 and IAS 12.24). It may apply, for example, on purchase of an asset with a zero tax base (ie for which no tax allowances are available). IAS 12 also makes it clear that subsequent depreciation of an exempted asset is also considered to result from initial recognition (IAS 12.22(c)). IFRS 1 does not state whether this exemption also applies for a first-time adopter.

In our view, this initial recognition exemption also applies on first-time adoption of IFRSs and includes assets and liabilities acquired before the date of transition to IFRSs. In applying IAS 12 to the opening IFRS statement of financial position, it is therefore necessary to consider the effects of the exemption as if the entity had always applied IFRSs. The amount of deferred tax recognised in the opening IFRS statement of financial position is adjusted accordingly.

Applying IAS 12 to the opening IFRS statement of financial position will therefore require:

- identification of those assets and liabilities to which the initial recognition exemption applies
- determination of any temporary differences in relation to those assets and liabilities not covered by the initial recognition exemption, such as revaluations. For this purpose a difference between actual cost (less depreciation) and deemed cost is considered to be a revaluation and
- recognition of deferred tax on the temporary differences not covered by the initial recognition exemption. Any adjustment to the amount of deferred tax recorded under previous GAAP is taken to opening retained earnings.

Deferred tax and business combinations

Note that the initial recognition exemption does not apply to assets acquired in a business combination. The guidance in this section therefore does not apply to assets acquired in a business combination. Deferred tax is provided for assets and liabilities acquired in a business combination.

6.2 Deferred tax on share options granted before 7 November 2002

IFRS 1.D2 provides an exemption from recognising an expense relating to equity-settled share-based payment arrangements granted prior to 7 November 2002. However, IFRS 1 does not include any similar exemption from recognising deferred tax on such an arrangement.

Share-based payments attract tax deductions in some jurisdictions. Where a deduction will be available in future periods in respect of a pre-7 November 2002 grant, a deductible temporary difference exists. In our view, a deferred tax asset should be recognised in respect of this difference subject to its recovery being probable (IAS 12.24). The credit in respect of the deferred tax asset recognised should be made to equity (retained earnings) in the opening IFRS statement of financial position. Subsequent movements in the deferred tax relating to these share-based payments should also be recognised in equity.

6.3 Intangible assets acquired in a pre-transition date business combination

If a first-time adopter has acquired intangible assets with a zero tax base in a pre-transition date business combination, is a deferred tax provision required? Is the corresponding adjustment made to goodwill or to opening retained earnings?

A deferred tax provision will be required in the opening statement of financial position if the intangible asset is recognised in the opening statement of financial position. The initial recognition exemption in IAS 12 does not apply to assets acquired in a business combination therefore a deferred tax provision will be required on the full taxable temporary difference.

Adjustments to deferred tax amounts recognised under previous GAAP may therefore be required. If the first-time adopter applies IFRS 3 'Business Combinations' (IFRS 3) retrospectively, the corresponding entry is made to goodwill and, where applicable, non-controlling interests. This approach follows from application of IFRS 3 under which goodwill is the excess of the consideration over the proportionate interest in the assets acquired and liabilities assumed.

If the first-time adopter decides not to apply IFRS 3 retrospectively, it applies the requirements in IFRS 1.C in accounting for the combination. Where this results in separate recognition in the opening IFRS statement of financial position of intangible assets acquired in the business combination, a deferred tax provision will be required on the full taxable temporary difference. If those assets were also recognised separately under previous GAAP, any consequent adjustment to deferred tax balances will lead to an adjustment to retained earnings. By contrast, if the assets were previously subsumed within recognised goodwill, adjustments to deferred tax will lead to adjustments to goodwill and (if applicable) non-controlling interests (IFRS 1.C4(g)).

7 Business combinations

7.1 Double-counting of fair value adjustments within goodwill

If a first-time adopter does not restate past business combinations, there will in some circumstances be a 'double-counting' of fair value adjustments to certain acquired assets if an equivalent fair value adjustment was included in goodwill under previous GAAP. This is because IFRS 1.C4(g) requires goodwill to be measured at its carrying amount under previous GAAP (with a few permitted adjustments). To illustrate, consider the following example.

Example 5: Double-counting of fair value adjustments

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. Its date of transition to IFRSs is 1 January 2011.

Entity A has opted not to apply IFRS 3 to past business combinations. It holds various investment properties and has opted to measure them using the IAS 40 fair value model.

Some of the investment properties originate from companies acquired in business combinations before 1 January 2011. These properties were not measured at fair value at the date of the acquisition under previous GAAP. Therefore the goodwill measured under previous GAAP includes (to some degree at least) the difference between fair value of the investment properties at the acquisition dates and the amounts recognised under previous GAAP business combination accounting.

Requirements

In accordance with IFRS 1.C4(d), the first-time adopter measures the investment properties at fair value in its opening IFRS statement of financial position, even if they were acquired in past business combinations. It recognises the resulting change in the carrying amount by adjusting retained earnings rather than goodwill.

The carrying amount of goodwill in the opening IFRS statement of financial position is the carrying amount under previous GAAP at the date of transition to IFRSs (with exceptions indicated under IFRS 1.C4(g)). Further, an impairment test of the goodwill has to be performed (IFRS 1.C4(g)(ii)).

Application of the requirements

Entity A performs an impairment test of goodwill (based on the cash-generating units). This reveals that no impairment of goodwill has to be recognised.

Consequently, the difference between fair value at the date of acquisition and its carrying amount at that date remains in goodwill under IFRSs.

Entity A recognises a fair value adjustment to the investment properties at 1 January 2011, which includes the amount included in goodwill. Accordingly, the difference between fair value and the carrying amount at the date of acquisition is double-counted in the opening statement of financial position as it is included within both investment properties and goodwill.

This approach is permitted under IFRSs. The consequence is some risk of double-counting within goodwill and other assets. The extent depends on whether previous GAAP required the acquired assets to be recognised at fair value. If so, there is no double-counting.

The IASB recognised this risk of double-counting but decided it was an acceptable risk as it is subject to the safety net of the impairment test of goodwill on transition to IFRSs. The alternative would be to require full retrospective application of IFRS 3, which they considered to be too costly and subjective (see IFRS 1.BC 39).

7.2 Intangible assets acquired in a past business combination

For intangible assets acquired in a past business combination, the rules are different depending on whether or not the intangible asset was recognised in the consolidated financial statements under previous GAAP. The implication of the rules in IFRS 1 Appendix C for intangible assets acquired in a past business combination is described in the following paragraphs (see also section C2.1.5).

When an intangible asset was recognised under previous GAAP, it is necessary to consider whether that intangible asset would qualify for recognition under IAS 38 'Intangible Assets' (IAS 38). If not, then the asset is not included in the opening statement of financial position (IFRS 1.C4(c)(i)). The item (along with any related deferred tax and non-controlling interests) is then reclassified into goodwill. In determining whether an intangible asset qualifies for recognition under IAS 38, we believe that the test is not whether an intangible asset would be recognised in the acquiree's separate financial statements. Rather, the question is whether the intangible asset would have been recognised under IFRS 3 and the parts of IAS 38 that apply to intangible assets acquired in a business combination (see IAS 38.33 – 34). This is important in practice because many assets that were internally generated by the acquiree (eg customer relationships assets) are often recognised under IFRS 3 but are not recognised in the acquiree's separate financial statements.

Example 6: Intangible asset was recognised under previous GAAP

Background

Entity A will prepare its first IFRS financial statements for the year ended 31 December 2012. Its date of transition to IFRSs is 1 January 2011.

It has acquired a subsidiary in a past business combination that occurred before 1 January 2011. Entity A does not restate past business combinations, ie it applies the exemption in IFRS 1.C.

At the acquisition date, the subsidiary had internally generated trademarks.

Under its previous GAAP, entity A recognised internally generated trademarks in the subsidiary. These trademarks were not recognised in the separate financial statements of the subsidiary under previous GAAP.

Application of the requirements

Management determines that the internally generated trademarks qualify for recognition under IAS 38 (IAS 38.33 – 34). Therefore, the intangible asset is recognised in the opening statement of financial position.

If the intangible asset did not qualify for recognition under IAS 38, entity A would be required to reclassify the intangible asset as part of goodwill (IFRS 1.C4(c)(i)).

If the intangible asset was not recognised under previous GAAP, IFRS 1.C4(f) requires the acquirer to recognise and measure it in its consolidated statement of financial position on the basis that IFRSs would require in the separate statement of financial position of the acquiree. This is not quite the same 'test' as the IFRS 1.C4(c) test for derecognising intangible assets that were recognised under previous GAAP (see above). This is because the rules for recognition of an intangible asset differ between the acquiree's separate financial statements and the consolidated financial statements of the acquirer.

The requirements are illustrated in the following example:

Example 7: Intangible asset was not recognised under previous GAAP

Background

Similar situation as described in Example 6 above, however entity A had not recognised internally generated trademarks at the date of acquisition under previous GAAP. The intangible asset was subsumed in goodwill.

Internally generated trademarks are still held by the subsidiary at 1 January 2011.

Application of the requirements

At 1 January 2011 entity A determines that the intangible asset does not qualify for recognition under IAS 38 in the separate statement of financial position of the acquiree (subsidiary). This is because it is internally generated (IAS 38.63).

Entity A does not recognise the internally generated trademarks in the opening statement of financial position because the asset does not qualify for recognition in the separate financial statement of the acquiree. The asset remains in goodwill under IFRSs (IFRS 1.C4(f)).

8 Venture capital organisations and investments in associates

A venture capital organisation, a mutual fund, unit trust or similar organisation, including investment-linked insurance funds, may elect to measure its interests in associates or joint ventures as a financial asset at fair value through profit or loss in accordance with IAS 39 (IAS 28.18).

If under previous GAAP the associate or the joint venture was not accounted for at fair value and no IFRS designation was made on initial recognition of the investment, can the investor designate the investment as at fair value through profit or loss (or classify it as held for trading) in accordance with IAS 39 at its date of transition?

IFRS 1.D19 permits the fair value option to be applied at the transition date for financial instruments in the scope of IAS 39. However, we believe that the IFRS 1.D19 option can be extended to associates and joint ventures held by a venture capital organisation, mutual fund, unit trust or a similar organisation.

9 Pre-transition share-based payments costs

IFRS 1.D2 permits a first-time adopter of IFRSs to elect not to apply the recognition and measurement requirements of IFRS 2 'Share-based Payment' (IFRS 2) retrospectively for grants on or before 7 November 2002, or to awards that vested before the date of transition to IFRSs. Should a first-time adopter of IFRSs that elects to apply the IFRS 1.D2 exemption reverse its accounting under previous GAAP at the date of transition to IFRSs?

It should be noted that such a reversal would only affect the opening equity allocations. IFRS 2 is silent on where in equity the credit entry to a share-based payment transaction should be reported. We believe it is acceptable to recognise the credit entry in retained earnings (although the distributability of that amount is a matter for national law not IFRSs). Accordingly, we also believe that there is no requirement to reverse previously recognised amounts.



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