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Assurance & Advisory

First-time adoption

A guide to IFRS 1

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Foreword

In 2001 the European Commission took a positive step towards creating a high quality European capital market by requiring the use of International Financial Reporting Standards (IFRS) for all entities listed on European stock exchanges. The European Commission set 2005 as the date for this move. As a result the International Accounting Standards Board (IASB) undertook a project to provide guidance and ease the burden on first-time adopters and published IFRS 1 **First-time Adoption of IFRS** in June 2003.

In order to assist preparers with first-time adoption of IFRS, the IASB set 31 March 2004 as the date to finalise the set of standards to be applied by the first-time adopters in 2005 (the stable platform). Between September 2003 and March 2004 the IASB issued several major new standards including IFRS 2 **Share-based Payment** and IFRS 3 **Business Combinations**. At the same time, the IASB also published revisions to 15 existing International Accounting Standards (IAS) as well as revisions to IAS 32 and IAS 39 dealing with financial instruments, including macro hedging. This document provides application guidance on the stable platform standards that apply to first-time adopters in 2005.

The matters addressed in this publication are intended to supplement the IASB's own guidance with our practical experience. However, this publication does not address all fact patterns or industry specific issues (e.g. banking and insurance). Further, the content of this publication is subject to change as new IFRS are issued or as the IFRIC issues further interpretations to IFRS 1. You are encouraged to consult a Deloitte Touche Tohmatsu professional regarding your specific issues and questions.

It is our intention to use our website, **www.iasplus.com**, to update the guidance in this publication as it evolves. We hope you will find this information useful in applying IFRS 1.

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Definitions

Date of transition	Beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements.
Deemed cost	Amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.
Fair value	Amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
First IFRS financial statements	First annual financial statements in which an entity adopts IFRS, by an explicit and unreserved statement of compliance with IFRS.
First IFRS reporting period	The reporting period ending on the reporting date of an entity's first IFRS financial statements.
First-time adopter	An entity that presents its first IFRS financial statements.
Opening IFRS balance sheet	The entity's balance sheet (published or unpublished) at the date of transition.
Previous GAAP	The basis of accounting that a first-time adopter used immediately before adopting IFRS.
Reporting date	The end of the latest period covered by financial statements or by an interim financial report.
Stable platform standards	Standards as included in the 2004 Bound Volume and all IASB material issued after 31 March 2004 (refer to Appendix D for a list of the stable platform standards).

Abbreviations

GAAP	Generally Accepted Accounting Principles
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards – comprising: • International Financial Reporting Standards (IFRS), • International Accounting Standards (IAS), and • Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

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I. Executive summary

On 19 June 2003, the International Accounting Standards Board (IASB) published IFRS 1 **First-time Adoption of International Financial Reporting Standards** (IFRS). Since then, substantial amendments have been made to IFRS 1 as a result of the improvements to the original IAS and the new IFRS. Therefore, we decided to issue this publication dealing with all the stable-platform standards, including IFRS 2 **Share-based Payment**, IFRS 3 **Business Combinations**, IFRS 4 **Insurance Contracts** and IFRS 5 **Non-current Assets Held for Disposal and Discontinued Operations**.

IFRS 1 establishes the transition requirements for the preparation of financial statements in accordance with the International Financial Reporting Standards for the first time. The general principle is that the IFRS effective at the reporting date are to be applied retrospectively to the opening IFRS balance sheet, the comparative period and the reporting period, however with certain important exceptions and exemptions, for example, concerning business combinations and pension liabilities.

The purpose of IFRS 1 is to ease the transition to IFRS globally, and also specifically for the many listed companies in the European Union which are to present consolidated financial statements in accordance with IFRS from 2005.

In addition to easing the transition to IFRS, the objective of IFRS 1 is to create comparability over time in an individual entity and also between different entities adopting IFRS for the first time at a given date rather than creating comparability between first-time adopters and entities that already apply IFRS, which was the main objective of the former requirements of SIC 8 **First-Time Application of IASs as the Primary Basis of Accounting**. SIC 8 required a first-time adopter to present its financial statements as if they had always been prepared in accordance with the standards and interpretations effective for the period of first-time application and subject to the transitional provisions of the relevant standards. IFRS 1 requires a first-time adopter to prepare its financial statements in accordance with the standards and interpretations effective at the reporting date, thus disregarding previous versions of IFRS and the transitional provisions of the standards.

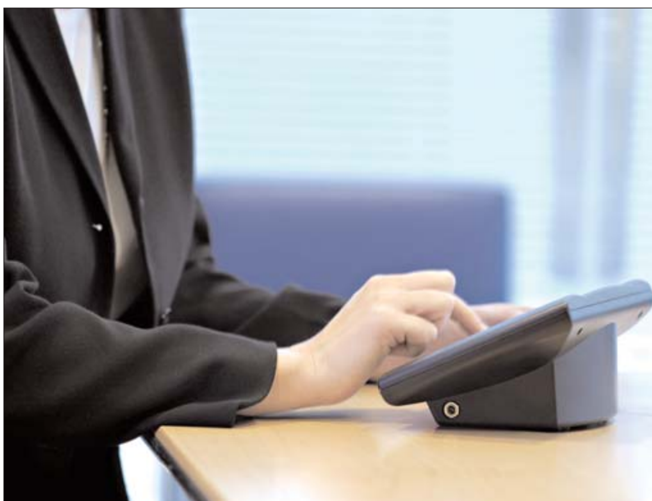
In this publication, we review the contents of IFRS 1 and focus on the significant consequences for companies that do not already state compliance with IFRS. The book also includes application guidance based on experience obtained from applying IFRS 1 in practice during the first year of its publication.

The approach taken in IFRS 1 is the "**Opening IFRS Balance Sheet Approach**". The main content of IFRS 1 is summarised in the following 10 points:

1. In its first IFRS financial statements, an entity shall comply with all the versions of IFRS effective at the **reporting date** (the balance sheet date) and as a general principle apply them retrospectively subject to certain exemptions and exceptions in IFRS 1. For example, entities that perform the transition to IFRS in 2005 shall comply with all standards effective at 31 December 2005.
2. An opening balance sheet shall be prepared in accordance with IFRS at **the date of transition**. The date of transition is the beginning of the earliest financial year for which full comparative information under IFRS is presented in its first IFRS financial statements. For companies listed in the EU with a calendar financial year that present one year of comparative information, the date of transition is therefore 1 January 2004.
3. The entity shall **recognise** all assets and liabilities in accordance with the provisions of IFRS, and derecognise assets or liabilities not in compliance with IFRS.
4. Assets and liabilities recognised in the opening IFRS balance sheet shall be **measured** in accordance with IFRS including IFRS 1.
5. All **accounting estimates** shall be determined in accordance with the guidance provided under IFRS.
6. The effect of **changes in accounting policies** shall be recognised in equity in the opening IFRS balance sheet, except for reclassifications between goodwill and intangible assets.
7. All the requirements in relation to **presentation and disclosures** under IFRS shall be fulfilled, including any reclassifications to comply with IFRS.
8. **Comparative information** for the prior period (e.g. 2004 for companies listed in the EU with a calendar financial year) shall be fully in accordance with IFRS (with certain exceptions e.g. on application of IAS 39 **Financial Instruments: Recognition and Measurement**). The IASB does not require more than one year of comparative information prepared under IFRS.
9. **Reconciliations between previous GAAP and IFRS** of a) equity at the date of transition and the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP, and b) profit or loss for the latest period in the entity's most recent annual financial statements, with supplementary explanations necessary for the understanding of the transition shall be presented.
10. There are certain **optional exemptions** and **mandatory exceptions** to the general principle in IFRS 1 of retrospective application. The exemptions have been granted in areas in which costs would be likely to exceed the benefits to the users of the financial statements and where it has in practice proven difficult to make changes retrospectively e.g. concerning business combinations and pension liabilities.

IFRS 1 expands the disclosure requirements previously included upon first-time adoption of IFRS with explanation of the transition to IFRS. Appendix A of this publication provides an illustrative example of applying the reconciliation requirements of IFRS 1 in a way that also supports the communication of switching to IFRS.

This publication aims to provide further guidance on how to apply IFRS 1 to some of the more significant and common issues and questions we have been faced with during the first year with the standard, however due to the nature of the subject is not intended to be all encompassing. Should you require further assistance in the application or implementation of IFRS 1, you are encouraged to consult a Deloitte professional regarding your specific issues and questions.



II. Summary of IFRS 1

A. Scope

An entity shall apply IFRS 1 in its first IFRS annual financial statements and in each interim financial report, if any, prepared in accordance with IAS 34 **Interim Financial Reporting** for part of the period covered by its first IFRS annual financial statements. An entity's first IFRS financial statements are the first annual financial statements in which it states compliance with IFRS in **an explicit and unreserved statement**. This means that IFRS 1 does not apply to entities that already apply IAS/IFRS.

There are a number of practical implications regarding the scope requirements and particularly regarding an entity's classification as a first-time adopter.

Illustration A – Examples of reserved compliance with IFRS

The following statements made in an entity's most recent financial statements are **not** explicit and unreserved statements of compliance and these companies would therefore be classified as first-time adopters:

- Compliant with local GAAP which is consistent with or similar to IFRS
- Compliant with IFRS except for certain standards or disclosures (for example, IAS 14 **Segment Reporting**)

Illustration B – Compliant with IFRS in prior years, but not the most recent previous year

Company B issued financial statements in 2001 and 2002 with an unreserved statement of compliance with IFRS. In its 2003 financial statements, Company B stated compliance with local GAAP only. Company B is a first-time adopter in 2004 because it did not make an explicit and unreserved statement of compliance with IFRS in its most recent previous financial statements.

An entity is also a first-time adopter if it prepared IFRS financial statements for internal use only, without making them available to its owners or any other external users.

Illustration C – Supplementary IFRS financial statements distributed to a financial institution

Company C prepares a supplementary set of its most recent previous financial statements stating compliance with IFRS. Company C distributes these financial statements to a select group of users, such as a financial institution. Company C is **not** a first-time adopter because it has issued its most recent financial statements stating explicit and unreserved compliance with IFRS. The extent of external distribution of the financial statements is irrelevant and the same would apply if an entity issued a set of IFRS financial statements to the counter parties of a commercial transaction.

The standard is effective for first IFRS financial statements beginning on or after 1 January 2004. Earlier application is, however permitted, bearing in mind any amendments to IFRS 1 as a consequence of the improved IAS standards (December 2003) and new IFRS standards issued in 2004.

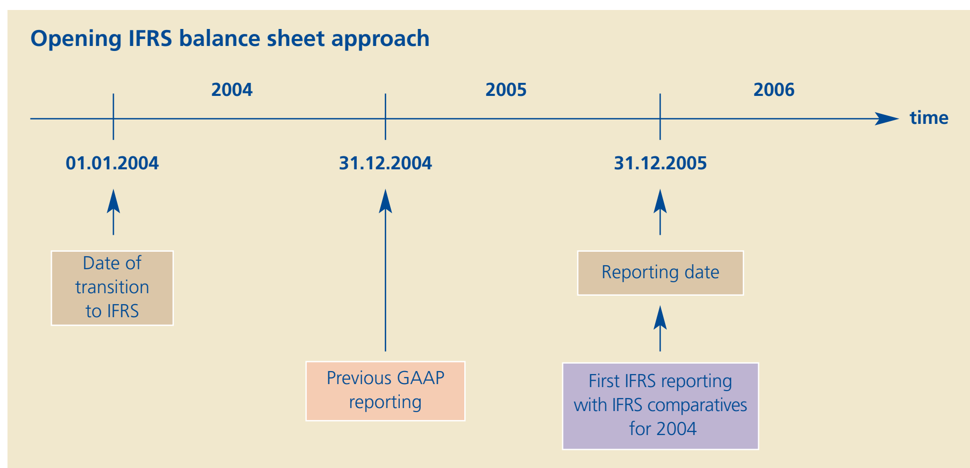
B. Recognition and measurement

The general principle

The general principle in IFRS 1 requires a first-time adopter to apply the version of IFRS effective at the reporting date **retrospectively,** and therefore the first IFRS financial statements are presented as if the entity had always presented financial statements in accordance with IFRS (subject to certain exemptions and exceptions, see below).

The **date of transition to IFRS** is defined as the "the beginning of the earliest period for which an entity presents full comparative information under IFRS in its first IFRS financial statements". A first-time adopter is required to prepare an **opening balance sheet** at the date of transition. This opening balance sheet is prepared in accordance with IFRS 1, including the general principle of retrospective application, the optional exemptions and mandatory exceptions. SIC 8 is no longer applicable. The opening IFRS balance sheet need not be published as part of the first IFRS financial statements, however it is used as a basis for preparation of those financial statements.

The following timetable illustrates first-time adoption of IFRS in 2005 for calendar year financial statements where comparative information is presented for one year:



The entity shall apply the same accounting policies both in the opening IFRS balance sheet and all periods presented in the first IFRS financial statements. This requirement is subject to certain exemptions and most notably that entities that adopt IFRS prior to 1 January 2006 need not apply IAS 32 and IAS 39 to the comparative information in their first IFRS financial statements.

As a first-time adopter is required to comply with all IFRS standards effective at the reporting date, it is important to note that the specific transitional provisions of the individual standards do not apply to a first-time adopter. Instead a first-time adopter prepares the opening balance sheet in accordance with the provisions of IFRS 1.

Generally, a first-time adopter is required to:

- recognise all assets and liabilities whose recognition is required by IFRS;
- not recognise items as assets and liabilities if IFRS do not permit such recognition;
- reclassify items 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 IFRS; and
- apply IFRS in measuring all recognised assets and liabilities.

Recognition and derecognition examples under IFRS

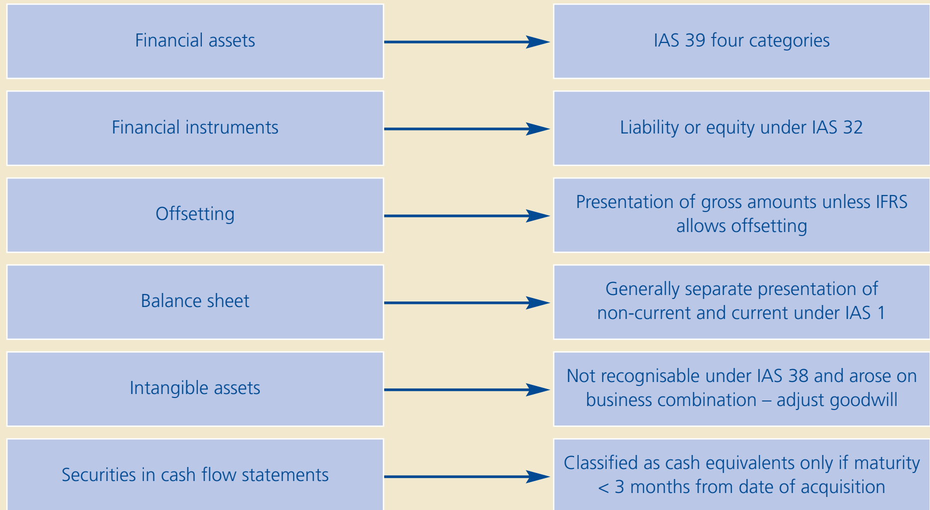
Recognise

- Pension lliabilities.
- Deferred tax assets and liabilities.
- Finance lease assets and liabilities.
- Provisions, only if legal or constructive.
- Derivative financial instruments.
- Acquired intangible assets.
- Internal development cost.

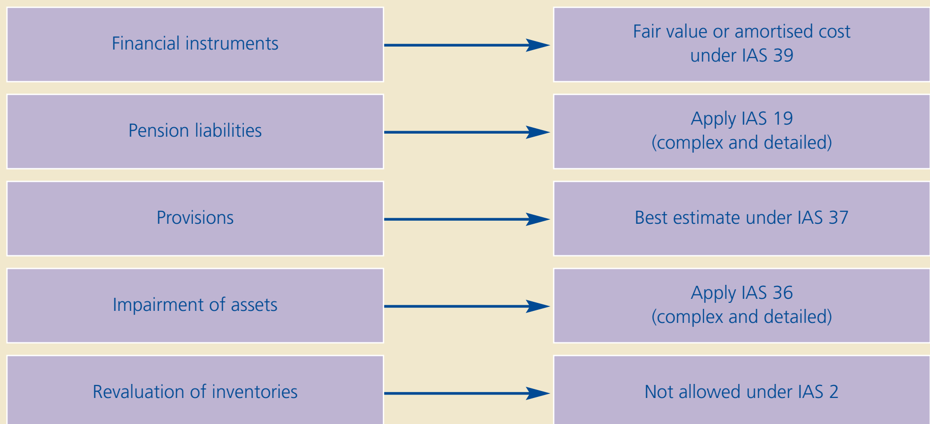
Derecognise

- Provisions, if no present obligation (e.g. certain restructuring liabilities).
- General reserves as liabilities.
- Deferred tax assets, if not probable.
- Treasury shares as assets.
- Intangible assets, not meeting criteria.

Reclassification examples under IFRS



Measurement examples under IFRS



The transition to IFRS could result in an entity having to change its accounting policies on recognition and measurement. The effect of this is generally recognised directly in equity in the IFRS opening balance sheet except in certain instances (e.g. intangible assets previously subsumed in goodwill). There are significant disclosure requirements relating to changes in accounting policies on transition to IFRS.

Furthermore, all IFRS presentation and disclosure requirements shall be fulfilled in the first IFRS financial statements. In particular, some of the standards which may have a significant impact on an entity's presentation and disclosure requirements are, IAS 14 **Segment Reporting**, IAS 19 **Employee Benefits**, IAS 32 **Financial Instruments**, IAS 33 **Earnings per Share**, IAS 36 **Impairment of Assets**, IAS 38 **Intangible Assets**, IFRS 2 **Share-based Payment**, IFRS 3 **Business Combinations** and IFRS 5 **Non-current Assets Held for Sale and Discontinued Operations**. In practice, fulfilling these disclosure requirements is onerous and numerous changes to reporting and information gathering systems may be necessary.

Optional exemptions

In a number of areas, retrospective application of IFRS will require significant resources and may in certain situations be impracticable. The IASB considered these situations and decided that the costs of applying IFRS retrospectively may exceed the benefits in certain instances. IFRS 1 therefore provides ten optional exemptions to the general principle of retrospective application. As these exemptions are optional, entities may change their accounting policies retrospectively in these areas if they desire, provided that they are able to calculate the effects reliably.

There are optional exemptions in the following areas:

O1) Business combinations;

O2) Fair value or revaluation as deemed cost;

O3) Employee benefits;

O4) Cumulative translation differences;

O5) Compound financial instruments;

O6) Assets and liabilities of subsidiaries;

O7) Designation of previously recognised financial instruments;

O8) Share-based payment;

O9) Insurance contracts; and

O10) Changes in existing decommissioning, restoration and similar liabilities.

An entity that elects to apply one of these exemptions is not required to apply any or all of the other exemptions. **Analogous application** of the above exemptions to other areas **is not permitted**.

O1: Business combinations

A first-time adopter may elect to account for a business combination prior to the date of transition in accordance with IFRS 3 **Business Combinations** or in accordance with Appendix B to IFRS 1. Retrospective application of IFRS 3 may be difficult and in certain cases impossible for past business combinations, and therefore it should be considered whether IFRS 3 can be applied with sufficient reliability for all business combinations.

An entity may apply IFRS 3 to business combinations prior to the date of transition provided that it obtained the information necessary to apply IFRS 3 at the date of the business combination. If an entity elects to apply IFRS 3 from a date earlier than the date of transition, all business combinations that occur subsequent to that date shall also be accounted for under IFRS 3. Business combinations before the date from which IFRS 3 is applied are accounted for in accordance with IFRS 1, Appendix B2.

The most significant provisions of IFRS 1, Appendix B2 are that:

- the classification of former business combinations (acquisitions or uniting of interests) shall be maintained;
- no remeasurement of original "fair values" determined at the time of the business combination (date of acquisition); and
- the carrying amount of goodwill recognised under previous GAAP is not adjusted, other than in the specific instances detailed below.

Assets and liabilities acquired in a business combination shall be recognised and measured in the opening balance sheet in accordance with IFRS. In general, the corresponding adjustment is recognised directly in equity, however that adjustment is recognised against goodwill in the following three instances:

- recognition of intangible assets acquired in a business combination that were not recognised under previous GAAP (i.e. subsumed in goodwill at the date of acquisition);
- derecognition of intangible assets acquired in a business combination that did not satisfy the criteria for recognition under IAS 38 **Intangible Assets** at acquisition date; and
- contingent adjustments to the purchase consideration for the acquired entity.

From the date of transition, goodwill is no longer amortised. As a result, IFRS 1 requires that an impairment test, in accordance with IAS 36 **Impairment of Assets**, of goodwill be conducted at the date of transition irrespective of whether an indication exists that goodwill may be impaired. The effect of any impairment as a consequence of this test is deducted from equity (commonly retained earnings) in the opening IFRS balance sheet.

Goodwill written off against equity under previous GAAP shall neither be recognised as an asset in the opening IFRS balance sheet nor included in the gain or loss on subsequent disposal or impairment of the subsidiary that gave rise to it.

If a subsidiary was not formerly consolidated in the consolidated financial statements, IFRS 1 requires that the first-time adopter adjust the carrying amounts of the subsidiary's assets and liabilities to the amounts that IFRS would require in the subsidiary's separate balance sheet and goodwill be calculated for this entity at the date of transition to IFRS. The deemed cost of goodwill is calculated as the difference between (i) the parent's interest in the subsidiary's equity as adjusted under IFRS at the date of transition and (ii) the parent's cost of the investment in the subsidiary at the date of acquisition.

O2: Fair value or revaluation as deemed cost

A first-time adopter may elect to measure individual items of property, plant and equipment at fair value at the date of transition to IFRS. Fair value is then deemed cost at that date. Deemed cost is an amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost. If the entity elects this exemption, there is no requirement that the method be applied for all items within the same category.

If under previous GAAP the entity revalued one or more categories of property, plant and equipment, the entity may elect to apply these values as deemed cost at the date of revaluation. The election is available only to the extent that the revaluation was, at revaluation date, broadly comparable to fair value, or cost (or depreciated cost) under IFRS adjusted to reflect for example, changes in a general or specific price index.

If in connection with a former event (e.g. a privatisation or an IPO), an entity measured assets and liabilities at fair value, the entity may apply these values as deemed cost at the date the valuation was performed.

Deemed cost forms the basis for the cost of the asset under IFRS at the date the valuation was performed and not the date of transition. Depreciation under IFRS is determined from the date deemed cost is applied up until the date of transition. An adjustment is recognised in retained earnings if the amount recognised under previous GAAP is materially different to the amount that would have been recognised under IFRS.

A first-time adopter may also use fair value or revalued amount as deemed cost in the same manner for items of investment property, if an entity elects to use the cost model in IAS 40, and intangible assets, provided that in the case of intangible assets the recognition criteria in IAS 38 are satisfied and fair value is determined with reference to an active market as defined in IAS 38.

O3: Employee benefits

Under IAS 19 **Employee Benefits**, pension plans are classified as either defined contribution plans or defined benefit plans. Accounting for defined benefit plans is significantly more complex than for defined contribution plans. Provisions for defined benefit plans are calculated on the basis of a number of actuarial assumptions, and cumulative actuarial gains and losses are recognised in accordance with IAS 19. In terms of IAS 19 an entity may elect not to recognise all actuarial gains and losses (also referred to as "the corridor-approach"). Retrospective application of the corridor approach would require cumulative actuarial gains and losses from the inception of each pension plan to be determined and split between recognised and unrecognised gains and losses at each balance sheet date in accordance with IAS 19.

IFRS 1 requires that the entity identifies all defined benefit plans and compares previous GAAP with IAS 19. Any changes in applied accounting policies are made retrospectively except for an optional exemption concerning actuarial gains and losses and the accumulated effect of the changes is taken to equity in the opening balance sheet.

The optional exemption enables the net pension obligation to be calculated as the present value of the pension obligation less the fair value of any related assets (adjusted for any unrecognised past service cost) without consideration of the "corridor-approach". This means that entities may elect to eliminate unrecognised actuarial gains and losses by setting them off against equity in the opening IFRS balance sheet. This exemption may result in a significant charge to total equity at the date of transition, but in return the entity avoids amortising the related losses in profit or loss. If the entity chooses this exemption, it is applied to all defined benefit plans in the group. Even if this exemption is applied in relation to the transition to IFRS, the entity is not precluded from applying the "corridor-approach" under IAS 19 in future periods.

O4: Cumulative translation differences

On translation of a foreign operation in accordance with IAS 21 **The Effects of Changes in Foreign Exchange Rates**, certain exchange differences are recognised as a separate component of equity. IAS 21 also requires an entity to disclose the net exchange differences classified as a separate component of equity as well as a reconciliation of the opening and closing balances. On subsequent disposal of a foreign operation, the accumulated translation differences related to the specific foreign operation are recognised in profit or loss for the period as part of the gain or loss on disposal of the subsidiary.

Under IFRS 1 a first-time adopter may elect not to calculate this translation difference retrospectively and thereby set corresponding translation differences at the date of transition, determined in accordance with previous GAAP, to zero. The gain or loss on subsequent disposal of a foreign operation then includes only foreign exchange differences that arose subsequent to the date of transition.

O5: Compound financial instruments

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

If the liability component is no longer outstanding at the date of transition, retrospective application of IAS 32 results in two categories of equity, the cumulative interest in retained earnings and the original equity component. This forms the basis for an exemption because retrospective application in this instance does not affect the size of equity, but rather the individual elements thereof. In terms of the exemption, provided that the liability component of the compound financial instrument is no longer outstanding on the date of transition to IFRS, the amount recognised is not required to be separated between a debt and equity component.

O6: Assets and liabilities of subsidiaries

If a subsidiary makes the transition to IFRS at a later point in time than its parent, the subsidiary may in its own opening IFRS balance sheet continue with the same carrying amounts that are used in the parent's consolidated financial statements before any consolidation adjustments. Alternatively, the subsidiary itself may choose to apply IFRS 1 at its date of transition.

A similar election is available to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it. The associate or joint venture may then continue with the same carrying amounts that were used as a reporting basis under IFRS by the entity that has significant influence or joint control over it.

If a subsidiary makes the transition to IFRS before the parent, the parent shall measure the assets and liabilities of the subsidiary in the consolidated financial statements in accordance with the carrying amounts in the separate IFRS financial statements of the subsidiary. In this case there are no exceptions.

O7: Designation of previously recognised financial instruments

IAS 39 **Financial Instruments: Recognition and Measurement** permits an entity to designate a financial asset or financial liability as at fair value through profit or loss or as available-for-sale. At the date of publication of this book, an outstanding exposure draft of proposed amendments to IAS 39 **The Fair Value Option** proposes to limit the circumstances in which the election is available. In terms of both the current and proposed amendments to IAS 39 that designation must be made at initial recognition.

Despite this requirement, IFRS 1 permits a first-time adopter, at the date of transition, to designate a financial asset or financial liability as at fair value through profit or loss or as available-for-sale. The basis for this exemption is that a first-time adopter applied previous GAAP at the date of initial recognition and would therefore not have been able to take advantage of the election which was available to entities already reporting under IFRS. If an entity uses this exemption it shall disclose certain information.

O8: Share-based payments

A first-time adopter has an option not to apply IFRS 2 **Share-based Payment** retrospectively to equity instruments (equity-settled transactions) granted on or before 7 November 2002. IFRS 1 provides an additional exemption from retrospective application of IFRS 2 for equity instruments that were granted after 7 November 2002 and that vested before the later of (a) the date of transition and (b) 1 January 2005. However, an entity may apply IFRS 2 to such equity instruments if it has previously disclosed publicly the fair value of those equity instruments, determined at measurement date, as defined in IFRS 2.

Further, if an entity modifies the terms or conditions of a grant of equity instruments to which IFRS 2 does not apply, it is not required to apply the provisions of IFRS 2 related to modifications, provided that the modification occurred prior to the later of (a) the date of transition and (b) 1 January 2005. If the modification postpones the vesting date to after 1 January 2005, IFRS 2 shall be applied to the entire transaction.

If a first-time adopter elects to apply the exemption it is nevertheless required to disclose information that enables users of the financial statements to understand the nature and extent of share-based payment arrangements that existed during the reporting and comparative periods.

In addition to the exemption regarding equity instruments, an entity may elect not to apply IFRS 2 retrospectively to share-based payment liabilities (cash-settled transactions) that were settled before the date of transition or prior to 1 January 2005. For liabilities to which IFRS 2 applies, comparative information after 7 November 2002 shall be restated.

O9: Insurance contracts

In contrast to the general principle of IFRS 1, an entity issuing insurance contracts (insurer) may elect on first-time adoption to apply the transitional provisions of IFRS 4 **Insurance Contracts**. These transitional provisions require an insurer to apply IFRS 4 prospectively for reporting periods beginning on or after 1 January 2005 with optional earlier application. This means that first-time adopters in 2005 need not apply IFRS 4 to their 2004 comparative information. IFRS 4 restricts changes in accounting policies for insurance contracts.

O10: Changes in existing decommissioning, restoration and similar liabilities

In terms of IFRIC 1 **Changes in Existing Decommissioning, Restoration and Similar Liabilities**, changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle an existing decommissioning, restoration or similar liability, or a change in the discount rate, shall be added to, or deducted from, the cost of the related asset. The adjusted depreciable amount of the asset is depreciated prospectively over its remaining useful life.

For a first-time adopter, retrospective application of these requirements would require an entity to construct an historical record of all such adjustments that would have been made in the past, which in many cases will not be practicable.

Therefore, under this optional exemption, an entity may elect, for such liabilities incurred before the date of transition, to:

(a) measure the liability at the date of transition to IFRS in accordance with IAS 37;

(b) estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period; and

(c) calculate the accumulated depreciation on that amount, as at the date of transition to IFRS, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity under IFRS.

The effect of any changes from previous GAAP as a result of this are recognised in the opening IFRS balance sheet at the date of transition in net assets and retained earnings.

Mandatory exceptions

The IASB has assessed that retrospective application of change in accounting policies in certain situations cannot be performed with sufficient reliability. Therefore, IFRS 1 contains four mandatory exceptions to the general principle of retrospective application.

The four mandatory exceptions are:

M1) Derecognition of financial assets and financial liabilities;

M2) Hedge accounting;

M3) Accounting estimates; and

M4) Assets classified as held for sale and discontinued operations.

M1: Derecognition of financial assets and financial liabilities

Financial assets and liabilities shall be recognised and measured in the opening IFRS balance sheet in accordance with the version of IAS 39 that is effective on the reporting date, for example, 31 December 2005 for companies listed in the EU with a calendar financial year. As an exception to this general principle, financial assets and liabilities for which derecognition was achieved before 1 January 2004 under previous GAAP are not required to be recognised again in the opening IFRS balance sheet. This provision is in accordance with the current specific transitional provisions of IAS 39 for existing IFRS users.

However, a first-time adopter may elect to apply the IAS 39 derecognition requirements retrospectively from an earlier date provided that the information required to do so was obtained at the time of initial accounting for the transaction.

M2: Hedge accounting

A first-time adopter is required in its opening IFRS balance sheet, to:

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

In terms of IAS 39 a hedging relationship only qualifies for hedge accounting if a number of restrictive criteria are satisfied, including appropriate designation and documentation of effectiveness at inception of the hedge and subsequently. As a result, in order for a hedging relationship to qualify for hedge accounting at the date of transition, the hedging relationship must have been fully designated and documented as effective in accordance with IAS 39 at the date of the transaction (when the hedging relationship was designated). Designation of a hedging relationship cannot be made retrospectively. However, if an entity designated a net position as a hedged item under previous GAAP, it may designate an individual item within that net position as a hedged item, provided that it does so no later than the date of transition.

Hedging relationships that were designated as hedges under previous GAAP, but which do not qualify for hedge accounting under IAS 39, shall be treated in accordance with the requirements of IAS 39 relating to the discontinuation of hedge accounting. This requirement applies only to hedges that were designated and documented at the date of the transaction.

A first-time adopter may under previous GAAP have deferred or not recognised gains and losses on a designated fair value hedge of a hedged item that is not measured at fair value. In that case the hedged item is adjusted in accordance with the implementation guidance to IFRS 1.

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

M3: Accounting estimates

Accounting estimates required under IFRS that were made under previous GAAP are not adjusted except for differences in accounting policies or unless there is objective evidence that they were in error. When restating the opening IFRS balance sheet, the entity may have information available that was not available at the time the estimate was made. The primary objective of this exception is to prevent entities from adjusting estimates that were made, based on the circumstances and information available at a particular date, with the benefit of hindsight. For example, a provision for inventory obsolescence that was made under previous GAAP shall not be adjusted unless the accounting policy under IFRS is different or it was erroneous. The comparative information presented in the first IFRS financial statements is also prepared on this basis.

An estimate required under IFRS that was not required under previous GAAP shall reflect conditions that exist at the date of transition. In particular, estimates of market prices, interest rates or foreign exchange rates shall reflect market conditions at the date of transition.

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

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

M4: Assets classified as held for sale and discontinued operations

The exception requires a first-time adopter to apply IFRS 5 retrospectively (i.e. in accordance with the general principle of IFRS 1) unless the date of transition is prior to 1 January 2005 in which case the transitional provisions of IFRS 5 apply.

Retrospective application of IFRS 5 requires an entity to reverse depreciation on non-current assets classified as held for sale from the date those assets satisfied the held for sale criteria. However, an entity that has a date of transition prior to 1 January 2005 shall not reverse previous depreciation of non-current assets classified as held for sale because it applies IFRS 5 prospectively in accordance with the transitional provisions of IFRS 5.

The transitional provisions of IFRS 5 require prospective application from 1 January 2005. However, if the valuation and other information needed to apply IFRS 5 retrospectively was obtained at the time the non-current assets originally met the criteria to be classified as held for sale, an entity may select an earlier date from which IFRS 5 is applied prospectively.

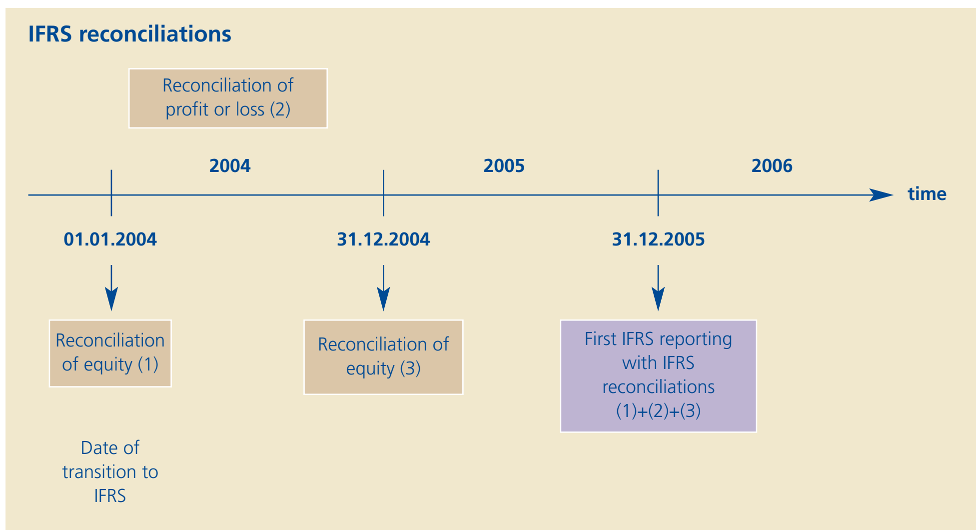
This exception is therefore temporary because an entity with a date of transition after 1 January 2005 is required to apply the general principle of retrospective application.

C. Presentation and disclosure requirements

The first IFRS financial statements shall be presented in accordance with the presentation and disclosure requirements in IAS 1 **Presentation of Financial Statements** and the other standards and interpretations under IFRS. IFRS 1 does not provide any relief from the presentation and disclosure requirements of the individual standards.

IFRS 1 requires that, in an entity's first IFRS financial statements, one year of comparative information be presented in accordance with IFRS. If the entity presents selective information for previous years or states key figures and ratios for previous years, IFRS 1 does not require that information to be prepared in accordance with IFRS. Instead, the entity shall clearly state in relation to the information that the figures are not calculated in accordance with IFRS and mention the most significant differences to IFRS. However, no requirement exists to disclose the amount of those differences.

A number of reconciliations between previous GAAP and IFRS are required in the first IFRS financial statements. These include reconciliations of equity at the date of transition and the beginning of the current reporting period as well as of the net profit or loss for the comparative period as illustrated below for an entity with a reporting date of 31 December 2005 disclosing one year of comparatives. Furthermore, supplementary explanations necessary for understanding the transition to IFRS are also required in the first IFRS financial statements. The reconciliations shall distinguish between errors made under previous GAAP (if any) and adjustments arising due to changes in accounting policies.



Interim reporting

IFRS does not require an entity to publish interim reports. Correspondingly, IFRS does not require that an entity publish interim reports in compliance with IAS 34 **Interim Financial Reporting**.

If, during the reporting period, the entity elects to prepare interim reports under IAS 34, IFRS 1 requires a range of further information in the interim report, including reconciliation between previous GAAP and IFRS as well as presentation of restated comparative information in accordance with IAS 34.

Illustration D – Reconciliations required in interim reports prepared in accordance with IAS 34.

Company D has a date of transition of 1 January 2004 and presents a quarterly report at 31 March 2005 in accordance with IAS 34. Company D presented an interim report under previous GAAP for the same period in the immediately preceding financial year. The following reconciliations are required under IFRS 1 in addition to those already required in IAS 34.

Equity at:

- the opening IFRS balance sheet date (1 January 2004);
- the end of the corresponding period in the prior year (31 March 2004); and
- the end of the latest annual financial year presented under previous GAAP (31 December 2004).

Profit or loss for:

- the comparable interim period (current and year-to-date) (1 January 2004 to 31 March 2004); and
- the latest annual financial year presented under previous GAAP (1 January 2004 to 31 December 2004).

Comparative information

To comply with IAS 1 an entity's first IFRS financial statements shall include at least one year of comparative information under IFRS. The date of transition to IFRS is defined as the beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements.

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

Illustration E – Two years of comparative information under IFRS

Company E is required due to its listing on a foreign stock exchange, to present two years of full comparative information. Company E is a first-time adopter in 2005 with a 31 December 2005 reporting date.

Company E's date of transition is 1 January 2003 because that is the beginning of the earliest period presented in its first IFRS financial statements. Consequently, all three periods presented, 2003, 2004 and 2005 shall be prepared in accordance with IFRS based on an opening IFRS balance sheet prepared at 1 January 2003. This includes comparative information for all components of financial statements in accordance with IAS 1 (i.e. balance sheet; income statement; statement of changes in equity, cash flow statement and all related note disclosure).

If an entity presents more than one year of comparative information not in accordance with IFRS, the entity shall a) label the previous GAAP information clearly and b) provide qualitative disclosure of the nature of the main adjustments that would make the information IFRS compliant.

Entities that adopt IFRS before 1 January 2006 are not required to apply IAS 32, IAS 39 and IFRS 4 to the comparative information presented in their first IFRS financial statements. If a first-time adopter makes this election its date of transition for the purposes of IAS 32, IAS 39 and IFRS 4 is the beginning of the current reporting period.

Other disclosures required by IFRS 1

If an entity recognised or reversed any impairment losses at the date of transition, it is required to disclose what IAS 36 would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition.

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

If the election to use fair value, revalued amount or an event driven value is applied to an item of property, plant and equipment, investment property or intangible asset, the following disclosure is required in the entity's first IFRS financial statements:

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

III. First-time adoption – Specific issues

The objective of this section is to deal with some of the most important specific issues related to application of IFRS 1 focusing on key impacts and major issues for first-time adopters, e.g. related to business combinations, financial instruments, derivatives, hedge accounting, pension liabilities, share-based payment, impairment of goodwill. Further, a number of illustrations highlight key consequences of applying IFRS 1.

A. Business combinations and goodwill

Relevant IFRS: IFRS 3 **Business Combinations**

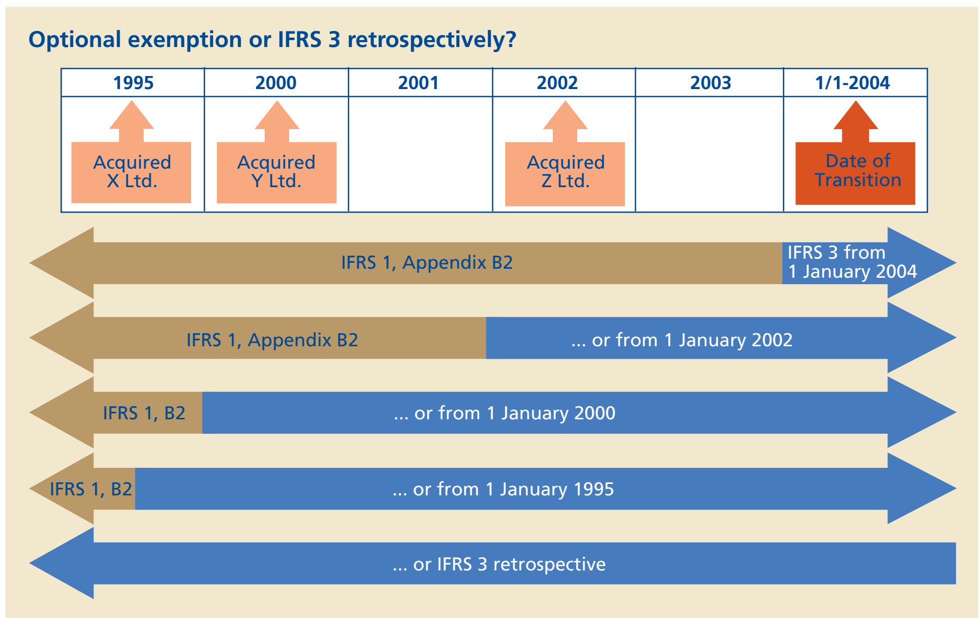
On 31 March 2004 the new standard for business combinations (IFRS 3) became effective. This standard superseded the old standard for business combinations (IAS 22). Consequently, if a first-time adopter applies the general principle of IFRS 1, it shall apply IFRS 3 retrospectively to all business combinations.

Application of IFRS 3 means that an entity is required to:

- account for all business combinations using the purchase method;
- identify an acquirer for all business combinations;
- measure the cost of the business combination;
- identify and recognise all assets (including, where relevant, additional intangible assets under IAS 38 **Intangible Assets** (revised 2004)) and all liabilities in accordance with IFRS, including contingent liabilities, but excluding any provision for restructuring, unless they were already recognised by the acquiree;
- measure the fair value of identified assets, liabilities and contingent liabilities at the date of acquisition, including minority interests;
- determine any goodwill or negative goodwill;
- allocate goodwill to cash generating units within the acquired business;
- not amortise goodwill; and
- perform an impairment test under IAS 36 **Impairment of Assets** (revised 2004) during each annual reporting period subsequent to the date of acquisition.

The requirements of retrospective application could be very onerous and in many cases impracticable because retrospective application of IFRS 3 in principle requires the entity to review all business combinations since incorporation of the entity. Therefore, IFRS 1 includes an optional exemption for business combinations.

A first-time adopter can apply the optional exemption to all business combinations that occurred before the date of transition. However, an entity may elect to apply IFRS 3 to a business combination before the date of transition, provided that all business combinations subsequent to that business combination are accounted for in accordance with IFRS 3. In other words, an entity may elect to apply IFRS 3 from an earlier date than the date of transition. If a first-time adopter decides to elect an earlier date, it shall also apply IAS 36 and IAS 38 from that same date and onwards. Business combinations before that date should be treated in accordance with the optional exemption in IFRS 1 and business combinations after that date should be accounted for under IFRS 3.



The selected date applies equally for acquisitions of investments in associates and interests in joint ventures.

Retrospective application

Retrospective application of IFRS 3 requires that the entity already has the information needed to apply the purchase method retrospectively in accordance with IFRS 3, which in particular include:

- calculation of the cost of the business combination;
- an identification of assets acquired (including any intangible assets), liabilities and contingent liabilities assumed;

- measurement of fair value at the date of acquisition of assets acquired, liabilities and contingent liabilities assumed; and
- impairment test of goodwill each year subsequent to the date of acquisition.

Adjustments to recognised goodwill, other assets and liabilities under previous GAAP and reversal of goodwill amortisation under previous GAAP related to the business combination are treated retrospectively in accordance with IFRS 3, and recognised directly in retained earnings. The effect of reversal of goodwill amortisation may, however be off-set to some extent by amortisation of intangible assets recognised separately from goodwill, because IFRS 3 is likely to require an entity to identify and recognise more intangible assets than were recognised under previous GAAP.

If the entity elects the date of transition (e.g. 1 January 2004) as the date from which it applies IFRS 3, goodwill amortisation recognised under previous GAAP in the 2004 consolidated financial statements shall be reversed in the first IFRS financial statements for 2005 in retained earnings at 1 January 2004. Comparative information for 2004 shall be restated correspondingly. Furthermore, goodwill shall be tested for impairment at 1 January 2004 under IAS 36 (revised 2004). Any resulting impairment adjustments shall be recognised in retained earnings at 1 January 2004. Business combinations for which the agreement date is during 2004 and 2005 shall be accounted for under IFRS 3.

However, if the entity elects to apply IFRS 3 for all business combinations after an earlier date, e.g. 1 January 2002, in addition to reversing goodwill amortisation for 2004 for all business combinations it is also required to reverse the goodwill amortisation recognised under previous GAAP in 2002 and 2003 related to those business combinations for which the agreement date is after 1 January 2002. However, this requires that the entity already has the information needed to apply the purchase method retrospectively in accordance with IFRS 3, and that goodwill is tested annually for impairment as from 1 January 2002 and that any impairment in the period 1 January 2002 to 31 December 2003 is recognised in retained earnings at 1 January 2004.

Application of optional exemption

Classification of previous business combinations

Under previous GAAP a business combination may have been classified differently than IFRS would require for the same business combination. There are a number of ways in which this could occur, depending on the requirements of previous GAAP, including, for example, when an acquisition is classified as:

- a uniting of interests which is not permitted under IFRS 3; or
- an acquisition following the legal form which should have been classified as a reverse acquisition under IFRS 3.

If an entity elects to apply the optional exemption for business combinations it **shall** keep the same classification as under previous GAAP. If the entity instead elects to apply IFRS 3 it shall change the classification to comply with IFRS 3 retrospectively.

Recognition of assets and liabilities

All assets acquired and liabilities assumed in a business combination that qualify for recognition under IFRS shall be recognised at the date of transition, except for some financial assets and liabilities derecognised under previous GAAP.

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

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

Assets acquired and liabilities assumed that do **not** qualify for recognition under IFRS, but were recognised under previous GAAP shall be derecognised. Resulting adjustments are recognised in retained earnings unless they relate to an intangible asset in which case they shall be recognised against goodwill.

Measurement of assets and liabilities

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

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

If an asset acquired or a liability assumed in a business combination was not recognised under, previous GAAP, it does not have a deemed cost of zero in the opening IFRS balance sheet. Instead, the acquirer shall recognise and measure those assets and liabilities in its consolidated balance sheet on the basis that IFRS would require in the separate balance sheet of the acquiree as if the acquiree had always applied IFRS. Resulting adjustments are recognised in retained earnings.

Illustration F – Finance lease not capitalised under previous GAAP

Parent Company F's date of transition is 1 January 2004. Parent Company F acquired Subsidiary M on 15 January 2001 and did not capitalise Subsidiary M's finance leases entered into prior to 15 January 2001. If Subsidiary M prepared separate financial statements under IFRS, it would recognise finance lease obligations of 750 and leased assets of 625 at 1 January 2004.

In its consolidated opening IFRS balance sheet, Parent Company F recognises finance lease obligations of 750 and leased assets of 625, and the net resulting change of 125 is recognised in retained earnings at that date.

Goodwill

In terms of the optional exemption for business combinations, goodwill shall be adjusted for the following items only:

Items	Adjustment to goodwill
Intangible assets recognised under previous GAAP but not under IFRS.	Carrying amount at date of transition of the intangible asset (less deferred tax and minority interests) is added to goodwill.
Intangible assets not recognised under previous GAAP but qualify for recognition under IFRS.	The amount at which the intangible asset would have been recognised in the separate IFRS financial statements of the subsidiary at the date of transition (less deferred tax and minority interests) is deducted from goodwill.
Contingency affecting the amount of the purchase consideration.	Goodwill shall be adjusted if: • the contingent adjustment has been resolved and settled before the date of transition but has not been reflected in the amount of goodwill under previous GAAP; • a reliable estimate of the contingent adjustment can be made and its payment is probable; or • a previously recognised contingent adjustment can no longer be measured reliably or its payment is no longer probable.
Impairment of goodwill.	Any resulting impairment loss from testing goodwill at the date of transition is deducted from goodwill.

In accordance with the optional exemption, resulting adjustments to goodwill are measured at the date of transition and **not** at the date of acquisition. The carrying amount of an intangible asset not recognised under previous GAAP shall be measured as other assets not recognised under previous GAAP, see above.

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

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

Regardless of whether there is any indication that goodwill may be impaired, goodwill shall be tested for impairment as at the date of transition. In order to do so goodwill shall be allocated to cash-generating units as defined under IAS 36.

As goodwill is not amortised under IFRS 3, the carrying amount of accumulated goodwill amortisation presented in the notes at the date of transition shall be adjusted against the original cost of goodwill. The net amount shall be carried forward as the new carrying amount.

Illustration G – Costs of development projects not recognised under previous GAAP

Parent Company G acquired Subsidiary B on 1 January 2001. Parent Company G adopts IFRS in 2005 with date of transition 1 January 2004. Under previous GAAP development costs were expensed as incurred. Had Subsidiary B applied IFRS, development costs of £20 would have been recognised related to a project completed at 31 December 1999. The useful life of the project is 5 years. The fair value is assessed to be £18 at 1 January 2001 and £10 at the date of transition 1 January 2004. Parent Company G is using the optional exemption for business combinations under IFRS 1, Appendix B2. The following journal entries are required at the date of transition:

	Dr.	Cr.
Dr. Development costs	20	
Cr. Accumulated amortisation [20 x 4/5]		16
Cr. Goodwill [20 – 16]		4

The development costs were not recognised under previous GAAP. The acquirer, Parent Company G, shall recognise and measure the development costs in its consolidated opening IFRS balance sheet on the basis that IFRS would require in the separate balance sheet of Subsidiary B. At the date of transition this amount is £4 (20 amortised over 4 out of 5 years). Goodwill shall be adjusted accordingly because the asset was previously subsumed within goodwill.

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

Illustration H – Amortisation of software not in compliance with IFRS

Parent Company H acquired Subsidiary B on 1 January 2001. Parent Company H adopts IFRS in 2005 with date of transition 1 January 2004. On 31 December 1999 Subsidiary B acquired software for £30. The useful life of the software is 6 years, however under previous GAAP, amortisation of software is restricted to the straight-line method over a maximum of 3 years. At 31 December 2002 the asset was completely amortised and was consequently removed from the accounting records. The fair value as at 1 January 2001 is assessed to be £25 which is equal to the carrying amount at the same date had Subsidiary B always applied IFRS. The useful life is unchanged at the date of acquisition which means that the remaining useful life at that date is 5 years. Parent Company H is using the optional exemption for business combinations under IFRS 1.

	Previous GAAP EUR	Separate financial statements had Subsidiary B always applied IFRS EUR
31 December 1999	30	30
31 December 2000	20	25
Date of acquisition = 1 January 2001	**20**	**25**
31 December 2001	10	20
31 December 2002	0	15
31 December 2003	0	10
Date of transition = 1 January 2004	**0**	**10**
31 December 2004	0	5
31 December 2005	0	0

The following journal entries are required at the date of transition:

	Dr	Cr
Dr. Software costs	20	
Cr. Accumulative amortisation [20 x 3/5]		12
Cr. Retained earnings [20 – 12]		8

The carrying amount under previous GAAP of the software immediately after the business combination is deemed cost (20). As software requires a cost-based measurement, deemed cost shall be the basis for amortisation under IFRS from the date of acquisition. The remaining useful life as of 1 January 2001 is 5 years and, consequently, the carrying amount in the opening IFRS balance sheet is 8 (20 amortised over 3 out of 5 years). Goodwill shall not be adjusted as software was recognised separately under previous GAAP but just fully amortised as at the date of transition, 1 January 2004.

Goodwill deducted from equity

If goodwill was deducted from equity under previous GAAP, a first-time adopter shall not recognise that goodwill as an asset in the opening IFRS balance sheet. Goodwill deducted directly from equity shall not be classified as a separate component of equity, but shall be deducted from retained earnings.

On disposal of the subsidiary or activity which gave rise to goodwill previously deducted from equity, the amount recognised in retained earnings at the date of transition is not transferred to profit or loss as part of the net gain or loss on disposal.

Subsequent adjustments to goodwill previously deducted from equity arising due to the resolution of a contingency affecting the purchase consideration shall be recognised in retained earnings. The same applies to intangible assets subsumed within goodwill and intangible assets not qualifying for recognition under IFRS.

Negative goodwill

In terms of the optional exemption for business combinations any negative goodwill recognised under previous GAAP shall be derecognised with the corresponding adjustment to retained earnings at the date of transition.

Subsidiaries not consolidated under previous GAAP

Under previous GAAP, an entity may not have consolidated a subsidiary acquired in a past business combination because, for example, it did not regard the investment as a subsidiary because it was classified as an associate under previous GAAP, the subsidiary was exempted for consolidation under previous GAAP; or the entity did not prepare consolidated financial statements under previous GAAP.

If a subsidiary was not consolidated the parent company shall at the date of transition identify assets and liabilities of the subsidiary and adjust the carrying amount to the amount that IFRS would require in the subsidiary's separate financial statements.

Goodwill of a non-consolidated subsidiary shall at the date of transition be calculated as the difference between:

- the entity's interest in the net assets recognised and measured as described above **at the date of transition**; and
- the original cost in the entity's separate financial statements of its investment in the subsidiary **at the date of acquisition**.

The procedures for determining goodwill on a non-consolidated subsidiary could lead to a significant amount of goodwill if the subsidiary has, subsequent to the date of acquisition, reduced the carrying amount of net assets either by distribution of pre acquisition reserves or by incurring significant losses. In all cases goodwill recognised shall be tested for impairment at the date of transition.

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

The treatment of non-consolidated subsidiaries can lead to some artificial amounts of goodwill because the cost of the investment and the amount of the assets and liabilities of the subsidiary are not calculated at the same date.

Illustration I – Subsidiary not consolidated under previous GAAP

Parent Company I's date of transition to IFRS is 1 January 2004. Under its previous GAAP, Parent Company I did not consolidate its 75 percent share of Subsidiary K, acquired in a business combination on 15 July 2001. On 1 January 2004:

(a) the cost of Company I's investment in Subsidiary K is £540 at the date of acquisition; and

(b) under IFRS Subsidiary K would measure its assets at £1 500 and its liabilities (including deferred tax under IAS 12) at 900. On this basis net assets of Subsidiary K are £600 under IFRS at the date of transition.

Parent Company I consolidates Subsidiary K. The consolidated opening IFRS balance sheet at 1 January 2004 includes:

(a) assets at 1 500 and liabilities at 900 of Subsidiary K;

(b) minority interests of 150 (25 percent of [1 500 – 900]);

(c) goodwill of 90 (cost of 540 less 75 percent of [1 500 – 900]); and

(d) the resulting adjustment of 540 (1 500 – 900 – 150 + 90) is recognised directly in retained earnings.

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

Minority interests and deferred tax

The measurement of minority interests and deferred tax follows from the measurement of other assets and liabilities.

The optional exemption in IFRS 1 contrasted with IFRS 3

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

B. Associates and joint ventures

Relevant IFRS: IAS 28 **Accounting for Investments in Associates**
IAS 31 **Financial reporting of Interests in Joint Ventures**

Consolidated financial statements

The optional exemption for past business combinations also applies to past acquisitions of investments in associates and interests in joint ventures (typically, investments in jointly controlled entities).

Under IFRS 1 a first-time adopter may select a date earlier than the date of transition to apply IFRS 3 retrospectively to business combinations, and only business combinations before that date should be treated in accordance with the optional exemption in IFRS 1, Appendix B2. A first-time adopter shall in those cases also apply IAS 28 and IAS 31 retrospectively to acquisitions of investments in associates and interests in joint ventures from the same date that IFRS 3 is applied retrospectively.

Under the optional exemption for business combinations, assets and liabilities in the opening IFRS balance sheet of the associate or the joint venture for the purpose of applying the equity method or proportionate consolidation shall be recognised and measured in accordance with IFRS 1, Appendix B2.

If an entity applies the optional exemption for business combinations, goodwill related to an investment in associate or joint venture shall only be adjusted in the same limited circumstances as for subsidiaries. Furthermore, any negative goodwill shall be eliminated.

Associate or joint venture adopts IFRS before the investor

An associate or joint venture may have made the transition to IFRS at some point in time before the investor. The investor shall measure the assets and liabilities of the associate or the joint venture in its consolidated opening IFRS balance sheet at the same carrying amounts as in the associate or the joint venture's own IFRS financial statements adjusted for the effect of applying the equity method or proportionate consolidation and for the effect of acquisition adjustments if required.

Classification of subsidiaries, jointly controlled entities or associates

Any reclassifications of an acquisition between a subsidiary, jointly controlled entity and associate shall be adjusted prospectively from the date of transition only, however:

- an investment previously classified as a subsidiary, jointly controlled entity or associate that does not meet any of those classifications under IFRS shall be accounted for retrospectively as an investment under IAS 39.
- investments in associates and interests in joint ventures that are not accounted for under the equity method in the consolidated financial statements under previous GAAP shall be accounted for in the same way as subsidiaries not consolidated under previous GAAP.

Separate financial statements of associates and joint venturers

If an associate or a joint venturer makes the transition to IFRS at a later point in time than its investor does for the consolidated financial statements, the associate or the joint venturer may in its own opening IFRS balance sheet continue with the same carrying amounts that are applied for consolidation purposes before any consolidation adjustments. Alternatively, the associate or the joint venturer may choose to apply IFRS 1 at its own date of transition.

C. Consolidation

Relevant IFRS: IAS 21 **The Effects of Changes in Foreign Exchange Rates**
IAS 27 **Consolidated and Separate Financial Statements**
IAS 29 **Financial Reporting in Hyperinflationary Economies**

In preparing consolidated financial statements under IAS 27 an entity combines the financial statements of the parent company and its subsidiaries line by line by adding together similar items of assets, liabilities, equity, income and expenses using uniform accounting policies for similar transactions and other events in similar circumstances, and eliminates in full all intra-group transactions and balances within the consolidated group.

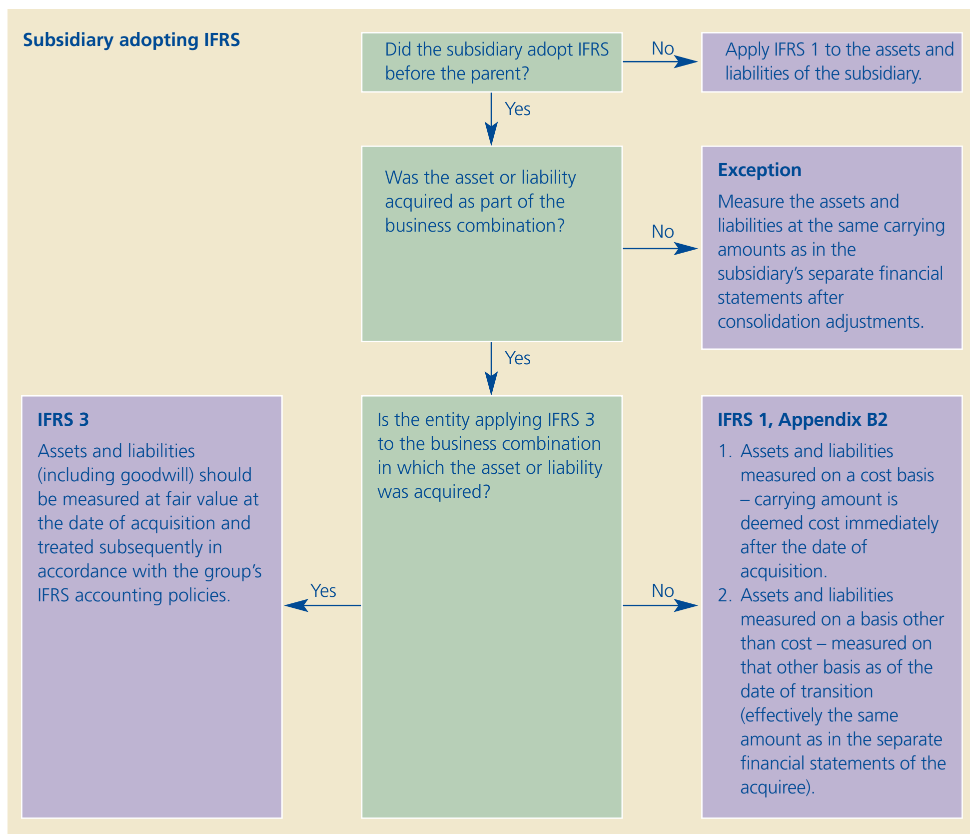
In preparation of the consolidated financial statements a first-time adopter should apply the provisions of IFRS 1 equally for all consolidated subsidiaries, except if the subsidiary adopted IFRS before the parent company did for the consolidated IFRS financial statements.

Consolidated financial statements

Subsidiary adopts IFRS before the parent

If a subsidiary makes the transition to IFRS before the parent does for the consolidated financial statements, the parent shall measure the assets and liabilities of the subsidiary in its consolidated opening IFRS balance sheet at the same carrying amounts as in the subsidiary's own IFRS financial statements adjusted for consolidation eliminations and for the effects of the business combination if the subsidiary is acquired in a past business combination.

Below, we have illustrated in a decision tree how to apply IFRS in the consolidated opening IFRS balance sheet to assets and liabilities of a subsidiary:



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

IAS 21 (revised 2003) requires goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity to be treated as part of the assets and liabilities of the acquired entity and translated at the closing rate.

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

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

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

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

Illustration J – Goodwill treated as an asset of an intermediate company under previous GAAP.

Before the date of transition, Company J (functional currency Euro) acquired 100% of the shares of Subsidiary B (legal entity based in the US), which is a company with several subsidiaries having different functional currencies (but mainly USD and CAD). The goodwill paid on acquisition of the shares of Company B was treated under previous GAAP as an asset of Company B (expressed in USD and translated into Euro at the closing rate). Company J does not elect to restate its business combinations before the date of transition.

In the present situation, the goodwill was not allocated to each of the foreign entities at the date of acquisition. It was treated as an asset of the acquired group's parent (Company B). In this case the acquired group's parent could be considered to be "the entity". Therefore, retrospective application of IAS 21 in this particular case would not be necessary. Accordingly, the goodwill will be translated at the current balance sheet date rate from USD to Euro at subsequent reporting dates.

Subsidiaries' functional currencies in hyperinflationary economies

IAS 29 **Financial Reporting in Hyperinflationary Economies** shall be applied to the financial statements of any entity whose functional currency is the currency of a hyperinflationary economy. This also applies to subsidiaries that have functional currency of a hyperinflationary economy.

When an entity prepares its opening IFRS balance sheet, it shall apply IAS 29 to any periods during which the economy of the functional currency or presentation currency was hyperinflationary.

Restating financial statements for the effects of hyperinflation in periods before the date of transition could be onerous, particularly if the currency is no longer hyperinflationary. However, retrospective application of IAS 29 is required, because hyperinflation can make unadjusted financial statements meaningless or misleading.

If a parent company did not, in its consolidated financial statements under previous GAAP, apply provisions similar to IAS 29 to its subsidiaries whose functional currency is the currency of a hyperinflationary economy, restatement of assets and liabilities of the subsidiary is required at the date of transition.

An entity may, however elect to use the fair value of items of property, plant and equipment, investment properties or intangible assets traded in an active market at the date of transition to IFRS as its deemed cost at that date. If an entity elects to use this exemption, it applies IAS 29 to periods after the date for which the revalued amount or fair value was determined.

Separate financial statements of the subsidiary

If a subsidiary makes the transition to IFRS at a later point in time than the parent company does for the consolidated financial statements, the subsidiary may in its own opening IFRS balance sheet continue with the same carrying amounts that are applied by the parent company for consolidation purposes before any consolidation adjustments. Alternatively, the subsidiary itself may choose to apply IFRS 1 at its own date of transition.

D. Separate financial statements of the parent company

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

IFRS does not require entities to prepare separate parent financial statements. The requirement for entities to produce separate financial statements and the basis under which they should be prepared is usually a matter of legislation in the jurisdiction in which the company is incorporated. Therefore, even if an entity prepares or is required to prepare consolidated financial statements under IFRS, it may prepare its separate parent company financial statements under local GAAP in accordance with the applicable legislation. For example, while listed entities in the European Union are required to prepare consolidated financial statements in accordance with IFRS from 2005, some countries require or permit those entities to prepare separate financial statements in accordance with local GAAP. This may in some instances involve two sets of accounting policies being published in the same annual report.

If an entity prepares separate financial statements under IFRS, IFRS applies equally to both consolidated financial statements and parent company financial statements. Therefore, in its separate financial statements an entity shall comply with all the IFRS effective at the reporting date including IFRS 1.

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

a) at cost; or

b) in accordance with IAS 39 (i.e. fair value).

Under the general principle of IFRS 1 an entity is required to apply IAS 27 retrospectively because there are no optional exemptions or mandatory exceptions for these investments.

A first-time adopter may elect either of these two measurement bases as its accounting policy under IFRS. The cost basis may have a material impact on an entity's equity if the entity accounted for investments in subsidiaries or associates using the equity method under previous GAAP because the entity's net share of the post-acquisition reserves of the subsidiary, jointly controlled entity or associate are reversed at the date of transition.

Apart from special requirements in IAS 27 regarding the accounting for investments in subsidiaries, jointly controlled entities and associates in the separate financial statements, there are no differences between applying IFRS in the consolidated financial statements and applying IFRS in the separate financial statements of the parent company, except for the effect of consolidation adjustments. Consolidation adjustments, which are not recognised in the separate financial statements, include profits and losses resulting from intra-group transactions that are recognised in assets, such as inventory and fixed assets, the effect of intra-group foreign currency hedge accounting and fair value adjustments to the carrying values of assets and liabilities acquired. If a parent becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

Investments in jointly controlled entities and associates that are accounted for in accordance with IAS 39 in the consolidated financial statements shall be accounted for in the same way in the separate financial statements.

E. Financial instruments

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

IAS 39 (revised 2003) sets out the detailed and complex rules and principles regarding recognition and measurement of financial assets and financial liabilities, including derivatives. IAS 39 interacts in many areas with IAS 32 (revised 2003) dealing with presentation and disclosure of financial instruments. IAS 32 also includes some of the key definitions of financial assets and financial liabilities as well as substantial guidance in relation to the distinction between equity and financial liabilities, especially in the area of derivatives on own equity instruments. IAS 39 provides detailed application and implementation guidance on scope, embedded derivatives, the recognition, derecognition, measurement of financial instruments (including provisions for hedge accounting).

The general principle of IFRS 1 requires a first-time adopter in its opening IFRS balance sheet to recognise, derecognise and reclassify all financial assets and financial liabilities (including derivatives) retrospectively in accordance with IAS 32 and IAS 39. When applying IAS 39 retrospectively the following three areas include significant first-time adoption issues:

- measurement at fair value or amortised cost;
- bifurcation and separate measurement of certain embedded derivatives; and
- classification of financial instruments issued as liabilities, equity or derivatives.

There are four instances in which retrospective application of those standards is either not required (i.e. retrospective application is optional) or not permitted:

- compound financial instruments (optional);
- designation of previously recognised financial instruments (optional);
- derecognition of financial assets and financial liabilities (optional under conditions); and
- hedge accounting (retrospective designation of hedges is not permitted).

Furthermore, IFRS 1 provides some relief regarding comparative information presented in the first IFRS financial statements with a date of adoption before 1 January 2006, as the comparative information need not comply with IAS 32 and IAS 39 (as well as IFRS 4 **Insurance Contracts**). If a first-time adopter makes this election its date of transition for the purposes of IAS 39 is the beginning of its first IFRS reporting period (e.g. 1 January 2005 for an entity with calendar year financial statements). If a first-time adopter does not restate its comparative information for IAS 32 and IAS 39, but applies previous GAAP for financial instruments, it shall, to compensate for the lack of comparability, disclose:

- this fact together with the basis used to prepare comparative information under previous GAAP;
- the nature of the main adjustments that it would need to make to comply with IAS 32 and IAS 39 (without needing to quantify those adjustments); and

- further information in accordance with sections of IAS 8 **Accounting Policies, Changes in Accounting Estimates and Errors** pertaining to the transitional provisions used, the nature of the change in accounting policies, the adjustments necessary on date of transition.

Measurement at fair value or amortised cost

There are a number of issues regarding measurement at the date of transition of certain financial assets and financial liabilities. These are found in the implementation guidance to IFRS 1 for the four categories of financial assets and are summarised below:

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

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

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

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

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

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

The carrying amount of a financial asset measured at cost or a financial liability measured at amortised cost in an entity's opening IFRS balance sheet is determined based on the circumstances existing when that instrument first satisfied the recognition criteria in IAS 39. However, this requirement does not apply to financial assets and financial liabilities acquired in a past business combination which are being treated in accordance with the exemption in IFRS 1, Appendix B2. If the financial asset acquired or financial liability assumed in the past business combination is measured at amortised cost under IAS 39, the carrying amount immediately after the business combination under previous GAAP is deemed cost under IFRS at the date of acquisition. To determine the carrying amount under IFRS at the date of transition, amortisation of this deemed cost is calculated using the effective interest method under IAS 39 since the date of acquisition, with this amortisation adjusting deemed cost.

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

Illustration K – Changes to impairment model of trade receivables at the date of transition

Company K has under previous GAAP applied an accounting policy for impairment of trade receivables based on historical statistical patterns (e.g. that 7% of all trade receivables would not be recoverable). Company K's first IFRS reporting period will be ending 31 December 2005 with the date of transition 1 January 2004, Company K needs to apply the impairment model under paragraph 58 of IAS 39 (revised 2003) based on objective evidence of impairment.

Although Company K does not need to restate comparative information for 2004 in its first IFRS financial statements in 2005, it does need to:

- determine any adjustments necessary on the date of transition due to the change in accounting policies between previous GAAP and the requirements of IAS 39. Company K shall recognise the effect of any adjustments arising from this in retained earnings at the date of transition; and
- ensure that the estimates made under IAS 39 at the date of transition are consistent with the estimates made under previous GAAP at the same date of each individual receivable. Only if there is objective evidence that those estimates were in error, shall Company K change its previous estimates and recognise the effect in retained earnings at the date of transition.

Bifurcation and separate measurement of certain embedded derivatives

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

Classification of financial instruments issued as liabilities, equity or derivatives

IFRS 1 requires an entity to recognise all financial instruments in accordance with IAS 32 and IAS 39. The classification of a financial instrument as an equity instrument or a financial liability is determined in accordance with IAS 32 (revised 2003). In particular compared to local GAAP in many countries and jurisdictions, IAS 32 requires that the classification as an equity instrument and a financial liability respectively be based on substance rather than legal form. This may result in reclassifications between equity and liability compared to previous GAAP for a first-time adopter, and a resulting impact on the financial position of the entity.

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

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

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

Derivatives on an entity's own equity instruments

Classifications of derivatives issued on an entity's own equity instruments are often complex. In practice, these instruments are commonly used to economically hedge risks associated with share-based payment or as part of the agreements in business combinations. Therefore, first-time adopters need to be aware of issues related to classification of various derivatives and instruments issued on their own equity instruments.

Classification of instruments	**Examples of contracts on own equity instruments with exclusively** gross physical settlement **("cash for shares")**	**Examples of contracts on own equity instruments with** net settlement **("cash for shares", "shares for shares" or an option for net settlement at the choice of either party).**
Financial liabilities	• Forward to buy shares. • Written put option on shares.	• Forward to buy shares or written put option on shares if one of the settlement alternatives is gross physical settlement.
Equity instruments	• Forward to sell shares. • Purchased call option on shares. • Written call option on shares. • Purchased put option on shares.	
Derivatives		• Forwards, purchased or written options, or total return swaps on its own equity instruments with net settlement in cash or in shares, and in the case of a forward to buy shares or written put option on shares there is no option to gross physically settle.

As illustrated in the table above, if an entity has an obligation to pay cash for buying back its own equity instruments (e.g. by entering into a gross physically settled forward to buy own shares), this gives rise to a financial liability measured at the share redemption amount (gross amount). This is the case notwithstanding the fact that the other side to the entry is to equity. The same treatment and measurement is required if a first-time adopter has issued a gross physically settled written put option on its own equity instruments, because the first-time adopter is obliged to deliver cash to the holder of the instrument if the holder exercises the right to require the issuer to buy back its own equity instruments.

If a first-time adopter has purchased either call or put options on its own equity instruments that are gross physically settled, it does not have the obligation to buy back or sell its own equity instruments. Therefore, these types of instruments are classified as equity. The same applies, if the entity has entered into a gross physically settled forward to sell shares, or written a gross physically settled call option on its own equity instruments.

Finally, if the first-time adopter has entered into forwards, purchased or written any options on its own equity instruments, that are settled net in cash (i.e. cash for cash), settled net in shares (i.e. shares for shares) or allow settlement in such ways as an option these types of instruments generally meet the definition of a derivative, and are classified and measured at fair value with gains and losses recognised in profit or loss. This category also includes situations where the first-time adopter has entered into a total return swap on its own equity instruments. The only exception is if the instrument is a forward to buy shares or a written put option on shares where one of the settlement alternatives is gross physical settlement. In this case a gross financial liability is recognised for the present value of the share redemption amount.

We encourage you to consult with a Deloitte professional if you have specific issues and questions related to derivatives on an entity's own equity instruments including cash settlement options.

Compound financial instruments

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

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

If the liability component is no longer outstanding, retrospective application of IAS 32 results in two categories of equity, the cumulative interest in retained earnings and the original equity component. This forms the basis for an exemption because retrospective application in this instance does not affect the size of equity, but rather the individual elements thereof. In terms of the exemption, provided that the liability component of the compound financial instrument is no longer outstanding on the date of transition to IFRS, that compound financial instrument is not required to be separated to the above-mentioned two components of equity.

Designation of previously recognised financial instruments

IAS 39 permits an entity to designate a financial asset or financial liability as at fair value through profit or loss or as available-for-sale. At the date of publication of this book, an outstanding exposure draft of proposed amendments to IAS 39 **The Fair Value Option** proposes to limit the circumstances in which the election with respect to designation as at fair value through profit and loss is available. In terms of both the current and proposed amendments to IAS 39 the designation shall be made at initial recognition.

Despite this requirement, IFRS 1 permits a first-time adopter, at the date of transition, to designate a previously recognised financial asset or financial liability as at fair value through profit or loss or as available-for-sale. The basis for this exemption is that a first-time adopter applied previous GAAP at the date of initial recognition and would therefore not have been able to take advantage of the election which was available to entities already reporting under IFRS. If an entity uses this exemption it shall disclose the fair value of any financial assets or financial liabilities designated into each category and the classification and carrying amount in its previous GAAP financial statements.

If a first-time adopter chooses not to restate comparative information for 2004 when it prepares its first IFRS financial statements for calendar year 2005, it shall make these designations at 1 January 2005 (this being its date of transition for IAS 32 and IAS 39).

Derecognition of financial assets and financial liabilities

Financial assets and liabilities shall be recognised and measured in the opening IFRS balance sheet in accordance with the version of IAS 39 that is effective on the reporting date, for example 31 December 2005. As an exception to this general principle, non-derivative financial assets and non-derivative financial liabilities for which derecognition was achieved before 1 January 2004 pursuant to previous GAAP are not required to be recognised again in the opening IFRS balance sheet (unless they qualify for recognition as a result of subsequent event or transaction). This provision is in accordance with the current specific transitional provisions of IAS 39 (revised 2003).

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

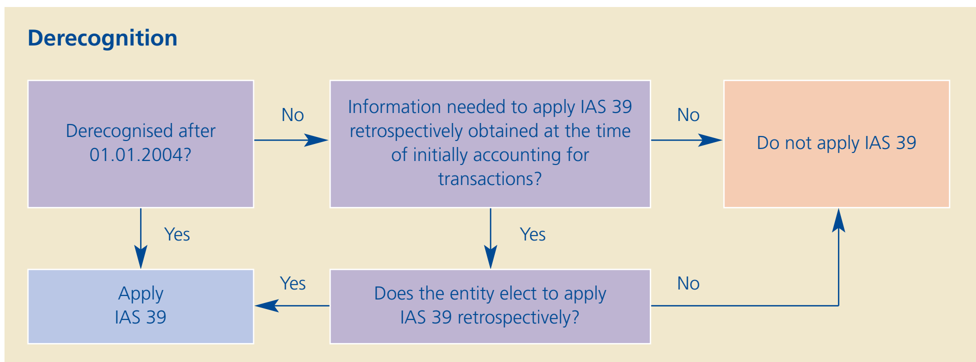


Illustration L – Derecognition of financial instruments at first-time adoption of IFRS

Company L transferred its trade receivables as part of a securitisation transaction before 1 January 2004. The receivables were derecognised in accordance with previous GAAP. Company L is adopting IFRS for the first-time in its financial statements for the year ending 31 March 2006. The entity chooses to present comparative information that is compliant with IAS 32, IAS 39 and IFRS 4 and hence its date of transition is 1 April 2004. Company L need not consider restating this securitisation transaction as it occurred prior to 1 January 2004 (specified date in IAS 39).

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

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

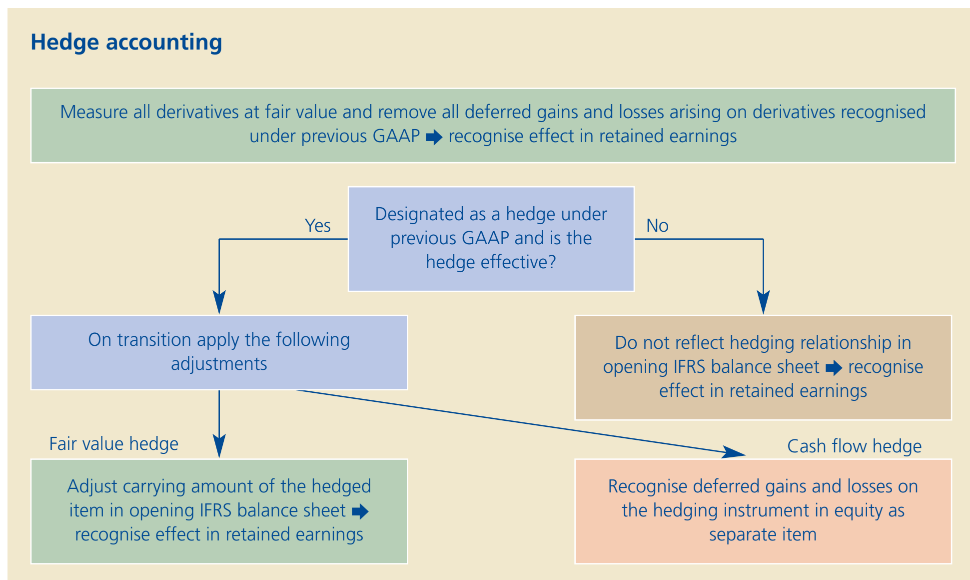
If the scheme involved a special-purpose entity (SPE), Company L, would also need to consolidate this entity retrospectively, if Company L controls the SPE as evaluated under IAS 27 **Consolidated and Separate Financial Statements** and SIC 12 **Consolidation – Special Purpose Entities**.

Hedge accounting

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

In terms of the exception, a first-time adopter is required in its opening IFRS balance sheet to recognise all derivatives at fair value and to eliminate against retained earnings all deferred gains and losses arising on derivatives that were reported under previous GAAP as assets and liabilities. The designation and documentation of the hedging relationship must be completed on or before the date of transition (e.g. 1 January 2004), if it is to qualify under IAS 39 for hedge accounting. However, a first-time adopter may also elect not to restate comparative information to comply with IAS 32 and IAS 39. In such a case the date of transition in terms of IAS 32 and IAS 39 will be the beginning of the first IFRS reporting period rather than the beginning of the comparative period (e.g. 1 January 2005).

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



Fair value hedge designated under previous GAAP

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

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

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

Illustration M – Application of the guidance on fair value hedges at date of transition

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

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

Cash flow hedge designated under previous GAAP

Under previous GAAP, gains and losses on a cash flow hedge of a forecast transaction may have been deferred in the balance sheet, or not recognised. If at the date of transition the forecast transaction is either still highly probable or not highly probable, but is still expected to occur, the entire deferred gain or loss is recognised in equity. A gain or loss so classified remains in equity until:

- the forecast transaction results in the recognition of a non-financial asset or non-financial liability;
- the forecast transaction affects profit or loss; or
- circumstances change and the forecast transaction is no longer expected to occur.

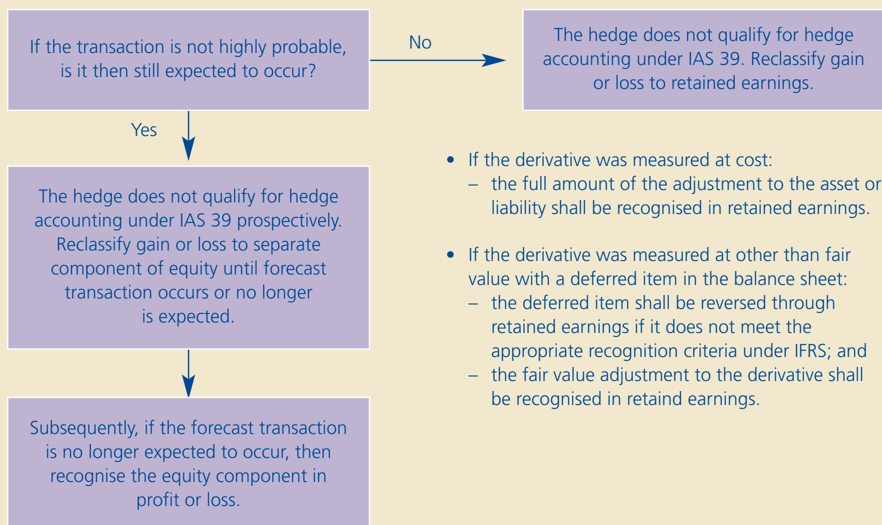
If the forecast transaction is not highly probable, but still expected to occur, the entity would not be able to hedge account prospectively (i.e. subsequent gains or losses on the hedging instrument are not eligible for deferral in equity).

Further, if a hedge designated under previous GAAP does not satisfy the hedge criteria in IAS 39, the entity applies paragraphs 91 and 101 of IAS 39 (revised 2003) dealing with discontinuing hedge accounting.

Illustration N – Discontinuing of hedge accounting

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

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



F. Employee benefits

Relevant IFRS: IAS 19 **Employee Benefits**

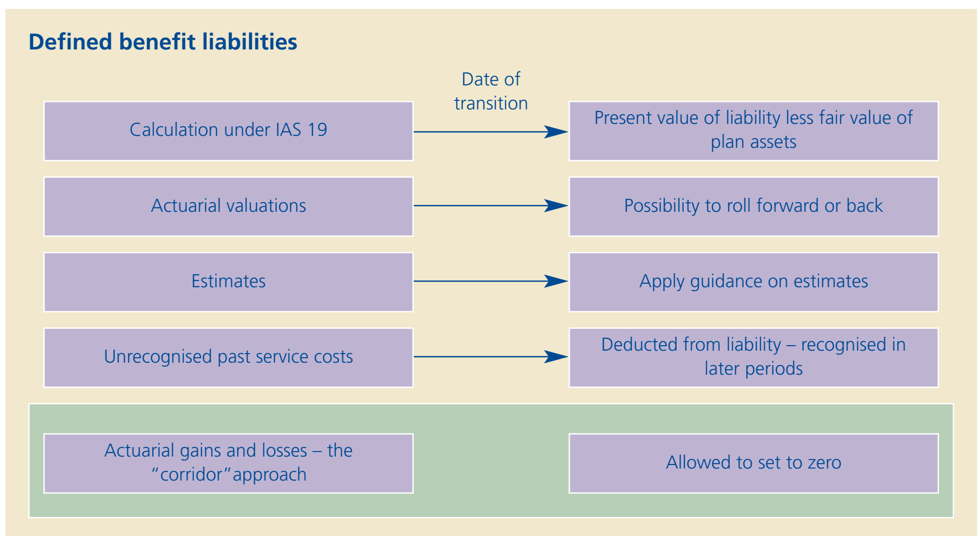
IAS 19 prescribes the accounting and disclosure by employers for the following categories of employee benefits:

- short-term employee benefits;
- post-employment benefits (pension plans);
- other long-term employee benefits; and
- termination benefits.

Share-based payments for goods and services received from employees and others are dealt with in IFRS 2 **Share-based Payments**.

Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans. Under defined contribution plans, an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. All other post-employment benefit plans are defined benefit plans.

At the date of transition employee benefits shall be treated in accordance with the general principle of IFRS 1, i.e. any changes in applied accounting policies are made retrospectively and the resulting changes are recognised in retained earnings in the opening IFRS balance sheet. Apart from accounting for defined benefit plans, it is not expected to be particularly onerous or impracticable to apply IAS 19 retrospectively, and therefore no exemptions from retrospective application have been granted in IFRS 1 in relation to other employee benefits.



Calculation under IAS 19

Under IAS 19 the carrying amount of a **defined benefit liability** is calculated as the net amount of the following:

1. present value of obligations to pay retirement benefits in future periods;
2. plus actuarial gains and less actuarial losses for which recognition is deferred – both within and outside the "corridor";
3. less unrecognised past service costs; and
4. less fair value of any related plan assets.

The present value of the defined benefit obligation shall be determined using **the Projected Unit Credit method** as defined in IAS 19.

Actuarial valuations

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

Estimates

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

Unrecognised past service costs

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

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

Actuarial gains and losses – the "corridor" approach

Provisions for defined benefit plans are calculated on the basis of a number of **actuarial assumptions** regarding demographic variables (such as employee turnover and mortality) and financial variables (such as inflation, future salary increases and discount rates), as well as on the basis of an **expected** long-term return on plan assets.

On an ongoing basis actuarial gains and losses will arise. They comprise the effect of:

1) differences between the previous actuarial assumptions and what has actually occurred;

2) changes in actuarial assumptions; and

3) differences between the expected return and actual return on plan assets.

In the long-term, actuarial gains and losses may offset one another and therefore the entity is not required to recognise all such gains and losses immediately. IAS 19 specifies that if the cumulative unrecognised actuarial gains and losses at the end of the previous reporting period exceed 10 percent of the greater of the defined benefit obligation or the fair value of plan assets **(the "corridor"**), that excess is recognised in future periods over the expected average remaining working lives of the participating employees. Actuarial gains and losses within the "corridor" need not be recognised – although the entity may choose to do so.

Retrospective application of the "corridor" approach would require cumulative actuarial gains and losses from the inception of each pension plan to be determined and split between recognised and unrecognised gains and losses at each balance sheet date in accordance with IAS 19. This would in most cases be impracticable unless the entity has applied similar accounting under previous GAAP and, consequently, IFRS 1 includes an **optional exemption** to retrospective application of the "corridor" approach.

Under this exemption an entity may elect to recognise all cumulative actuarial gains and losses up to the date of transition. If the entity chooses this exemption, it shall apply it for all defined benefit plans, however the entity is not precluded from applying the "corridor" approach for actuarial gains and losses which arise after the transition.

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

Illustration O – Previous GAAP similar to IAS 19

In Country O, a local standard on employee benefits became effective for annual financial periods beginning on or after 1 January 2004 with the possibility of earlier application. The local standard is similar to IAS 19. Company A domiciled in country O has chosen to adopt this standard early for its previous GAAP financial statement as from 1 January 2003, and use the "corridor" approach for defined benefit liabilities according to this standard as from this date.

Under the local standard, Company A recognised the net defined benefit liability at 1 January 2003 without any deferrals, corridors etc., however a new corridor-effect will arise during 2003 and 2004.

Company A will be a first-time adopter in 2005. Under IFRS 1, paragraph 20 a first-time adopter has only two choices regarding defined benefit liabilities,

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

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

Therefore, if Company A wishes to maintain the carrying amount of the defined benefit liability under previous GAAP (i.e. the corridor is set to zero at 1 January 2003 and not at 1 January 2004), Company A's date of transition must be 1 January 2003, and consequently Company A would have to present two full years of IFRS comparatives in the 2005 financial statements. If 1 January 2004 is the date of transition, the net liability will have to be recalculated once again as of this date, thereby eliminating the 2003-corridor effect against retained earnings.

G. Share-based payment

Relevant IFRS: IFRS 2 **Share-based Payment**

IFRS 2 is the international financial reporting standard dealing with accounting for and disclosures of share-based payment transactions. The standard deals with situations where an entity grants shares or share options to employees or other parties providing goods or services. IFRS 2 requires these share-based payments to be recognised as an expense. The amount charged as an expense shall be measured at fair value of the goods or services received unless, for equity-settled transactions, that fair value cannot be measured reliably. In these cases, which are deemed to include employee share options, the fair value of the equity instruments granted shall be measured. This amount is recognised at grant date or allocated over the vesting period, if any, attached to the scheme.

The standard deals with three types of share-based payment transactions: equity-settled, cash-settled, and with cash-alternatives. Equity-settled transactions are measured at fair value at grant date only. Cash-settled transactions are measured at fair value at each balance sheet date until exercise. Cash-alternatives transactions are measured partly as equity-settled and partly as cash-settled transactions – the determination of which depends on whether the entity or counter party has the choice of settlement.

Equity-settled transactions

IFRS 1 includes two exemptions for equity-settled transactions – illustrated graphically below:

1. Similar to entities already applying IFRS, first-time adopters will not be required to apply IFRS 2 for equity-settled share-based payments granted on or before 7 November 2002. However, the entity has the option to apply IFRS 2 earlier if fair value has previously been disclosed.

2. Additionally, a first-time adopter is not required to apply IFRS 2 to share-based payments granted after 7 November 2002 that vested before the later of a) the date of transition to IFRS and b) 1 January 2005. However, the entity has the option to apply IFRS earlier if fair value has previously been disclosed.

In all other situations, a first-time adopter shall apply IFRS 2 retrospectively with changes to comparative information provided in the first IFRS financial statements.

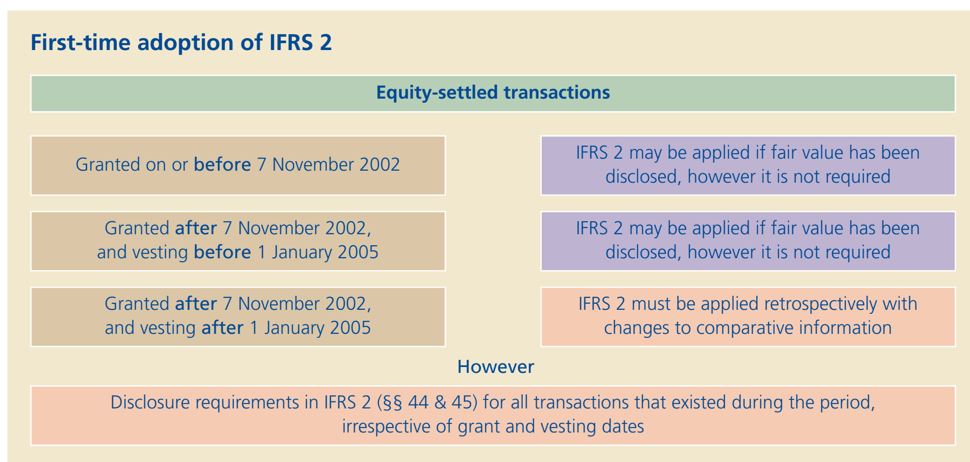


Illustration P – Transition to IFRS 2 for first-time adopter in 2005

Company P is a first-time adopter of IFRS with a reporting date of 31 December 2005 and a date of transition of 1 January 2004. Company P shall apply IFRS 2 fully for all share-based payment transactions that were granted after 7 November 2002 and have not vested at 1 January 2005. For share-based payment transactions granted after 7 November 2002, but vested as of 1 January 2005, Company P may only apply IFRS 2 if Company P previously disclosed the fair value of those share-based payments determined at the grant date, in accordance with IFRS 2. Therefore, a first-time adopter presents results similar to an entity currently applying IFRS with an effective date of 1 January 2005.

Considerable judgement will be required to determine the appropriate valuation of these share-based payment transactions retrospectively for a first-time adopter (as well as existing IFRS users). IFRS 1 provides some guidance in relation to estimates and restrictions on the use of hindsight, which is useful to the fair value measurement of equity-settled transactions.

Illustration Q – Measurement of equity-settled share-based payment on first-time adoption of IFRS

Company Q is adopting IFRS for the first-time with a date of transition of 1 January 2004 and a reporting date of 31 December 2005. Company Q issued share options on 30 June 2003 that do not vest until 30 June 2006. The transaction is classified as equity-settled. In accordance with IFRS 1, Company Q is required to apply IFRS 2 to the June 2003 grant of share options. Under Company Q's previous GAAP, Company Q did not estimate (or disclose) fair value determined as of 30 June 2003 in accordance with IFRS 2. As these estimates were not required under previous GAAP, the measurement shall reflect conditions that exist at the date of transition to IFRS (IFRS 1, paragraph 33). Company Q shall use information available at 1 January 2004 to determine expected volatility, expected dividends, and expected life of the options under the equity-settled transaction. However, some inputs to the valuation model are based purely on contractual or historical fact, in which case, that historical information shall be used. Therefore, the share price, exercise price and risk-free rate shall be based on information available at grant date – in this case 30 June 2003.

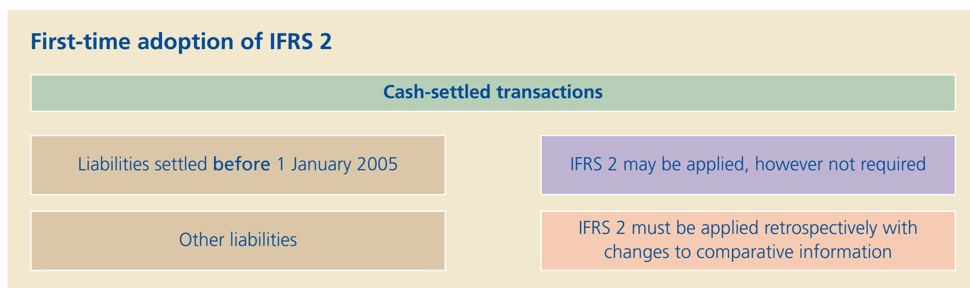
Irrespective of the grant dates and vesting dates of a first-time adopter's equity-settled share-based payment transactions, the entity shall disclose information that enables the users to understand the nature and extent of share-based payment arrangements that existed during the period. For a first-time adopter this includes providing a limited, however still significant, amount of disclosures for all equity-settled transactions that existed during the period (e.g. 2005 for first-time adopters with a reporting date of 31 December 2005) in its first IFRS financial statements. The first-time adopter shall provide a description of:

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

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

Cash-settled transactions

IFRS 1 also provides an exemption from retrospective application for liabilities arising from share-based payment transactions similar to that provided for existing IFRS users. A first-time adopter is required to apply IFRS 2 to liabilities arising from share-based payment transactions that were not settled at the later of a) the date of transition to IFRS and b) 1 January 2005. However, an entity is encouraged to apply IFRS 2 to share-based payments that were settled prior to 1 January 2005. Comparative information after 7 November 2002 shall be restated. This is illustrated graphically below.



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

Illustration R – Measurement of cash-settled share-based payment on first-time adoption of IFRS

Company R is adopting IFRS for the first time with a date of transition of 1 January 2004 and a reporting date of 31 December 2005. Company R issued share options on 30 November 2003 that do not vest until 30 November 2006. The share options can be cash-settled only, and are therefore classified as such. The vesting conditions are related to continued employment only. In accordance with IFRS 1, Company R is required to apply IFRS 2 to the November 2003 grant of share options, as the liability is not settled before 1 January 2005. Under previous GAAP, Company R has not estimated (or disclosed) fair value determined as of 30 November 2003 in accordance with IFRS 2, however it recognised and measured the liability in its previous GAAP financial statements at the difference between the exercise price and the current share price at 31 December 2003.

At the date of transition, 1 January 2004, and at each reporting date until it is settled, Company R shall measure the liability, at its fair value, by applying an option pricing model, taking into account the terms and conditions on which the share options were granted, and the extent to which the employees have rendered service to date. The fair value of cash-settled share-based payment includes both the intrinsic value and the time value. Time value is in this context defined as "…the value of the right to participate in future increases in the share price, if any, that may occur between the valuation date and the settlement date". The exclusion of the time value would lead to an inadequate measure of the liability.

To conclude, this means that the amount recognised under previous GAAP at 31 December 2003, which was based on the difference between the exercise price and the current share price at 31 December 2003, **cannot** be used as an approximation to fair value of the options under IFRS 2 at 1 January 2004.

Modifications to existing share-based payment transactions

A significant current issue related to first-time adoption of existing share-based payment transactions is how to account for any changes in settlement methods (e.g. from equity-settled to cash-settled and vice versa) prior to 1 January 2005.

Illustration S – Modification of share-based payment transaction after the date of transition, but prior to 1 January 2005

Company S issued cash-settled share-based payments on 1 January 2003 to certain of its employees that vest on 31 December 2005, if the individuals remain employed with Company S. Company S has a date of transition of 1 Januaury 2004. In addition, on 30 September 2004, Company S decides to modify the instruments such that they can only be settled by the issuance of Company S's shares after they vest on 31 December 2005.

Company S is encouraged, but not required, to apply IFRS 2 to liabilities that were settled before 1 January 2005. If Company S chooses not to apply IFRS 2 prior to 1 January 2005, the liability from 1 January 2004 through 30 September 2004 would not be recognised in Company S's first IFRS financial statements. Furthermore, if Company S modifies the terms or conditions of a grant of equity instruments to which IFRS 2 has not been applied, the entity is not required to apply the provision in IFRS 2 related to modifications if the modification occurred before the later of (a) the date of transition to IFRS, and (b) 1 January 2005. Therefore, Company S would only account for the equity-settled share-based payment from 30 September 2004 in its first IFRS financial statements if it will vest after 1 January 2005.

For consistency purposes, if Company S chooses not to apply IFRS 2 to the above transaction, it should not apply the modification guidance (that is, only recording incremental fair value), as part of the modification would not exist at the balance sheet date. On the other hand, if Company S chooses to apply IFRS 2 to the above transaction, the guidance for modifications in IFRS 2, paragraphs 26-29 shall be followed.

Neither IFRS 1 nor IFRS 2 provide much guidance in the area of modifications before the effective date of the standard. Therefore we encourage you to consult with a Deloitte professional if you have specific issues and questions related to changes in settlement methods (or other modifications) of existing share-based payment schemes.

H. Intangible assets

Relevant IFRS: IAS 38 **Intangible Assets**

The general principle in IFRS 1 requires a first-time adopter to recognise, derecognise and reclassify intangible assets in terms of IFRS. Resulting adjustments are generally recognised in retained earnings, except in certain cases where the adjustment is recognised against goodwill. This means that intangible assets, which would have satisfied the recognition criteria in IAS 38 at the time the asset was acquired or developed, shall be recognised in accordance with IAS 38 at the date of transition.

IAS 38 prohibits the recognition of internally generated goodwill, but requires recognition of certain internally generated intangible assets to the extent that the recognition criteria are satisfied. These criteria include that an original assessment was made and documented that showed, at the time, that the economic benefits attributable to the asset were expected to flow to the entity and the costs could be measured reliably. An entity cannot therefore recognise, in the current period, internally generated intangible assets that it did not recognise in the past on the basis that the recognition criteria were not satisfied even if it is possible to reconstruct the costs reliably. However, a first-time adopter shall recognise internally generated intangible assets that satisfied the recognition criteria in IAS 38 at the date incurred, regardless of whether those assets were expensed under previous GAAP.

Under IAS 38 intangible assets with an indefinite useful life shall not be amortised. Therefore, if an entity applies IAS 38 retrospectively it is required to reverse any accumulated amortisation recognised under previous GAAP. Instead of amortisation, IAS 38 requires that these intangible assets be tested for impairment at each reporting date. The indefinite useful life assessment is reviewed at each reporting date to ensure it is still appropriate. A change in the useful life assessment from indefinite to definite is accounted for as a change in accounting estimate.

In terms of IAS 38 an entity may select as its accounting policy either the cost or revaluation model for measurement after recognition of intangible assets. The revaluation model is only available where the revaluation amount can be determined reliably by reference to an active market. IAS 38 prescribes three criteria for an active market, (a) the items traded are homogenous; (b) willing buyers and sellers can be found at any time; and (c) the price is available to the public. This requirement is very restrictive and in most instances the entity will effectively be required to apply the cost model. Revaluations shall be performed with sufficient regularity to ensure that the carrying amount is not materially different to the fair value at the reporting date.

A first-time adopter has, aside from the normal requirements of the applicable IFRS, a number of options available regarding measurement of intangible assets at the date of transition. The general principle regarding measurement is to determine the cost as if IFRS had always applied, i.e. retrospective application.

Fair value election

IFRS 1 contains a fair value election which permits first-time adopters to use fair value at the date of transition as deemed cost at that date. This election is available to property, plant and equipment, investment property and intangible assets. If a first-time adopter applies this election to one intangible asset, it is not required to apply it to all other intangible assets in the same category.

The election is only available for intangible assets to the extent that recognition criteria in IAS 38 are satisfied and the fair value is determined by reference to an active market. A first-time adopter may elect to measure an intangible asset at fair value at the date of transition regardless of whether the entity selects, as its accounting policy, to measure intangible assets under the cost model. Resulting adjustments are recognised in retained earnings unless the intangible asset was previously subsumed in goodwill.

Revaluation or event driven value

IFRS 1 permits a first-time adopter to measure an intangible asset at a revalued amount determined under previous GAAP, provided that the revaluation was at the date of revaluation, broadly comparable to fair value, or to cost or amortised cost adjusted to reflect changes in prices. Deemed cost is the revaluation amount at revaluation date and not at the date of transition. The first-time adopter shall determine the appropriate amortisation charge in terms of IFRS from revaluation date up until the date of transition. If the amortisation charge under IFRS is materially different to that amount determined under previous GAAP an adjustment shall be recognised in retained earnings at the date of transition.

Illustration T – Election to use fair value or revalued amount

Company T's accounting policy under previous GAAP was to revalue intangible assets every three years and to recognise the resulting adjustments in equity. Intangible assets were not amortised under previous GAAP. Company T acquired a sugar supply quota on 1 January 2002 for €500. The quota was revalued on 31 December 2002 to €600. The quota expires on 31 December 2007. The revaluation was based on an active market and was broadly comparable to fair value. The sugar quota was not acquired as part of a business combination and Company T elects the cost model as its IFRS accounting policy for intangible assets. The fair value of the quota at the date of transition determined with reference to an active market is €750. Company T has a date of transition of 1 January 2004. Company T has an option to measure the sugar quota a) at fair value at the date of transition, b) to use the previous GAAP revaluation, or c) to apply IAS 38 retrospectively. The following journal entries are required in each instance:

a) **Fair value at 1 January 2004:**

Dr. Intangible asset [750 – 600]	150	
Cr. Retained earnings		150

b) **Previous GAAP revaluation:**

Dr. Retained earnings [600 x 1/5]	120	
Cr. Accumulated amortisation		120
Additional amortisation subsequent to the revaluation date		

c) **Retrospective application of IAS 38:**

Dr. Retained earnings [500 x 2/6]	167	
Cr. Accumulated amortisation		167
Amortisation subsequent to the date of acquisition		
Dr. Revaluation reserve	100	
Cr. Intangible asset [600 – 500]		100
Reversal of revaluation under previous GAAP		

Some items may have been measured at fair value at some time prior to the date of transition because of an event such as a privatisation or initial public offering. In these instances, the first-time adopter may elect to use the fair value determined on the date of the event as deemed cost at that date. Similar to revaluations, the first-time adopter shall determine the appropriate amortisation charge in terms of IFRS and adjust accordingly.

Acquired in a business combination

If a first-time adopter elects not to apply IFRS 3 retrospectively, a first-time adopter applies IFRS 1, Appendix B2. Recognition and measurement of intangible assets is then dependent on whether the item was recognised under previous GAAP and whether it satisfies the recognition criteria in IAS 38.

IFRS 1, Appendix B2 – Intangible assets recognised under previous GAAP

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

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

Illustration U – Intangible asset acquired in a business combination and recognised under previous GAAP

Parent Company U acquired Subsidiary S on 1 January 2002. At that date it recognised a fishing license at fair value of $350. The fishing license had a remaining useful life of 7 years at the date of acquisition. Under previous GAAP, Parent Company U measured intangible assets subsequently at cost and did not amortise. The carrying value on 1 January 2004 is therefore $350. Parent Company U has selected as its accounting policy to subsequently measure intangible assets under the revaluation model in IAS 38. The fair value of the fishing license on 1 January 2004 determined with reference to an active market is $430. Parent Company U has a date of transition of 1 January 2004. Parent Company U has an option to measure the fishing license at a) fair value at the date of transition, or b) previous GAAP revaluation. The following journal entries are required in each instance:

a) **Fair value at 1 January 2004:**

	Dr	Cr
Dr. Fishing license asset [430 – 350]	80	
Cr. Retained earnings		80

b) **Carrying amount immediately after the date of acquisition:**

	Dr	Cr
Dr. Retained earnings	100	
Cr. Accumulated amortisation [350 x 2/7]		100

IFRS 1, Appendix B2 – Intangible assets **not** recognised under previous GAAP

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

Illustration V – Intangible asset acquired in a business combination and not recognised under previous GAAP

Parent Company V acquired Subsidiary T on 1 January 2002. Subsidiary T had incurred development costs up to the date of acquisition amounting to £350. The development costs satisfied the recognition criteria in IAS 38 at the date of acquisition, however the asset was not recognised under previous GAAP. The development costs relate to a project with a useful life of 7 years starting from 1 January 2002. No active market exists where such costs are traded. Parent Company V has selected as its accounting policy to measure intangible assets after recognition in terms of the cost model. Parent Company V has a date of transition of 1 January 2004. The following journal entries are required:

Dr. Development costs	350	
Cr. Accumulated amortisation [350 x 2/7]		100
Cr. Goodwill [350 – 100]		200

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

Retrospective application of IFRS 3

If a first-time adopter elects to apply IFRS 3 retrospectively to intangible assets acquired in a business combination, these assets shall be recognised in accordance with IAS 38 and IFRS 3 at the date of transition and the appropriate adjustment shall be made against goodwill at the acquisition date. This is effectively retrospective application of IFRS 3 and may result in the recognition of more intangible assets.

I. Property, plant and equipment and investment property

Relevant IFRS: IAS 16 **Property, Plant and Equipment**
IAS 40 **Investment Property**

The general principle in IFRS 1 requires an entity to recognise, derecognise or reclassify items in terms of the applicable IFRS. Adjustments resulting from recognising or derecognising items of property plant and equipment and investment property are in all instances recognised in retained earnings at the date of transition.

The fundamental approach to recognising and measuring property, plant and equipment under IFRS does not differ significantly from most other significant reporting frameworks, however the types of costs to be capitalised under IFRS may be different to those recognised under previous GAAP. However, the componentisation approach for property, plant and equipment under IFRS may have significant implications for some first-time adopters. The componentisation approach requires amortisation to be determined separately for each significant part of an item of property, plant and equipment. In terms of IFRS 1, adjustments arising as a result of new or different depreciation policies under IFRS as opposed to previous GAAP should be processed to the extent they are material and unless the entity applies the optional exemptions in IFRS 1. Componentisation of assets is required retrospectively. The result of this can be illustrated as follows.

Illustration W – Componentisation of assets

Company W (a commercial airline) acquired an aircraft on 1 January 2002. The total cost included the cost of the engines, the on-board furnishings (seats, carpets etc.) and the in-flight entertainment system. Under previous GAAP, the total cost was capitalised and depreciated (straight line over economic useful life of 25 years) as one item in the fixed asset register.

Under IAS 16 each component of the aircraft (i.e. the engines, the furnishings and the entertainment system) should have been recognised and depreciated separately. IFRS 1 requires an entity to adjust the depreciation recognised under previous GAAP if the amount that would have been recorded under IFRS is materially different.

Company W is required therefore to allocate the total cost of the aircraft to the various components and calculate the appropriate depreciation charge under IFRS up to the date of transition. The level of componentisation is a matter of judgement and IAS 16 requires a component to be recognised if its cost is significant in relation to the total cost of the asset. Assuming that the useful life of the engines and other components is significantly less than 25 years, the depreciation charge under IFRS for these components will be different to that recorded under previous GAAP. An adjustment is recognised in retained earnings at the date of transition if the amount of that difference is material to the financial statements.

Under IAS 16 an entity may select as its accounting policy either the cost or revaluation model for measurement after recognition of property, plant and equipment. In terms of IAS 40 an entity may select as its accounting policy for measurement after recognition of investment property either the cost or fair value model. Further, items of property, plant and equipment (with the exception of land) must be depreciated. Investment property measured in accordance with the cost model in IAS 40 must also be depreciated. The fair value model in IAS 40 does not require investment property to be depreciated, but changes in the fair value at each reporting date are recognised in profit or loss.

In some cases, the construction or commissioning of an asset results in an obligation for an entity to dismantle or remove the asset and restore the site to its original condition. In such cases an entity may be required to recognise a liability under IAS 37.

A first-time adopter has, aside from the normal requirements of the applicable IFRS, a number of options available regarding measurement of items of property, plant and equipment and investment property at the date of transition. The general principle regarding measurement is to determine the cost as if IFRS had always applied, i.e. retrospective application.

Fair value election

In terms of IAS 40 a first-time adopter may elect as its accounting policy to measure investment property at fair value. If the entity makes this election it shall apply fair value measurement to all items of investment property at the date of transition determined in accordance with IAS 40.

IFRS 1 contains a fair value election which permits entities to use fair value at the date of transition for items of property, plant and equipment, investment property and intangible assets as deemed cost at that date regardless of the IFRS accounting policy they select. The election applies to all items of property, plant and equipment and investment property not already recognised at fair value. Fair value under this election shall be determined at the date of transition and in accordance with any related guidance in IFRS for that item. The resulting adjustment is recognised in retained earnings, or in another category of equity if appropriate, at the date of transition. The election also applies to items of property, plant and equipment and investment property acquired as part of a business combination. If a first-time adopter makes this election, it is not required to apply it to all items within each class.

Revaluation or event driven value

IFRS 1 permits a first-time adopter to measure an item of property, plant and equipment or investment property at a revalued amount determined under previous GAAP, provided that the revaluation was at the date of revaluation, broadly comparable to fair value, or to cost or depreciated cost adjusted to reflect changes in prices. Deemed cost is the revaluation amount at revaluation date and not at the date of transition. The first-time adopter shall determine the appropriate depreciation charge in terms of IFRS from revaluation date up until the date of transition. If this amount is significantly different to the depreciation amount determined under previous GAAP an adjustment shall be processed to retained earnings at the date of transition.

Illustration X – Election to use fair value or revalued amount

Company X acquired a factory building for €360 on 1 January 2002 with an expected remaining useful life of 40 years at that date. The building was revalued on 1 January 2003 to €390 and the resulting adjustment was recognised in equity. The building had a depreciated carrying value of €351 on 1 January 2003 and €380 on 1 January 2004. The depreciation method under previous GAAP is acceptable in terms of IAS 16 and the revaluation was broadly comparable to fair value at the date of revaluation. Company X selects the cost model as its accounting policy for measurement after recognition of buildings in accordance with IAS 16. Company X has a date of transition of 1 January 2004. At 1 January 2004 the building had a market value of €415. Company X has an option to measure the building at a) fair value at the date of transition, b) the previous GAAP revaluation, or c) to apply IAS 16 retrospectively. The following journal entries are required in each instance:

a) **Fair value at 1 January 2004:**

Dr. Factory building [415 – 380]	35	
Cr. Retained earnings		35
Adjustment of carrying amount to fair value as deemed cost		
Dr. Revaluation surplus [390 – 351]	39	
Cr. Retained earnings		39
Reversal of original revaluation at 1 January 2003		

b) **No journal entry is required as the depreciation under previous GAAP is acceptable in terms of IAS 16.**

c) **Retrospective application of IAS 16:**

Dr. Revaluation surplus [390 – 351]	39	
Cr. Factory building [390 – 360]		30
Cr. Accumulated depreciation		9
Reversal of original revaluation at 1 January 2003		
Dr. Accumulated depreciation [(390 x 1/39) – (360 x 1/40)]	1	
Cr. Retained earnings		1
Reversal of additional depreciation on revaluation at 1 January 2004		

Some items may have been measured at fair value at some time prior to the date of transition because of an event such as a privatisation or initial public offering. In these instances, the first-time adopter may elect to use that fair value determined on the date of the event as deemed cost at that date. Similar to revaluations, the first-time adopter shall determine the appropriate depreciation charge in terms of IFRS and adjust accordingly up to the date of transition.

Acquired in a business combination

If a first-time adopter elects not to apply IFRS 3 retrospectively, it applies IFRS 1, Appendix B2. Recognition and measurement of property, plant and equipment and investment property is then dependent on whether the item was recognised under previous GAAP.

IFRS 1, Appendix B2 – Property, plant and equipment and investment property recognised under previous GAAP

In terms of IAS 40 a first-time adopter may elect to measure investment property at fair value. If the entity makes this election it shall apply fair value measurement to all investment property. If the entity elects, as its accounting policy, to measure investment property at fair value, investment property shall be measured at fair value at the date of transition. Fair value under this election shall be determined at the date of transition and in accordance with any related guidance in IFRS for that item.

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

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

Illustration Y – Tangible asset acquired in a business combination and recognised under previous GAAP

Parent Company Y acquired Subsidiary Company S on 1 January 2001. As part of the business combination it acquired and recognised a shipping vessel at fair value of $6 000. The vessel had a remaining useful life of 12 years at the date of acquisition of company S. The vessel was revalued on 1 January 2003 to fair value of $6 500 and the resulting adjustment was recognised in equity. The carrying value on 1 January 2004 determined in terms of an IAS 16 compliant revaluation policy is $5 850. Parent Company Y has selected as its accounting policy to measure shipping vessels after recognition in terms of the cost model in IAS 16. The fair value of the vessel is $7 000 on 1 January 2004. Parent Company Y has a date of transition of 1 January 2004. Parent Company Y has an option to measure the shipping vessel at a) fair value at the date of transition, b) the previous GAAP revaluation, or c) carrying amount immediately after acquisition. The following journal entries would be passed in each instance:

a) **Fair value at 1 January 2004:**

	Dr	Cr
Dr. Shipping vessel [7 000 – 5 850]	1 150	
Cr. Retained earnings		1 150

b) **No journal entry is required as the depreciation under previous GAAP is acceptable in terms of IAS 16.**

c) **Carrying amount immediately after the date of acquisition:**

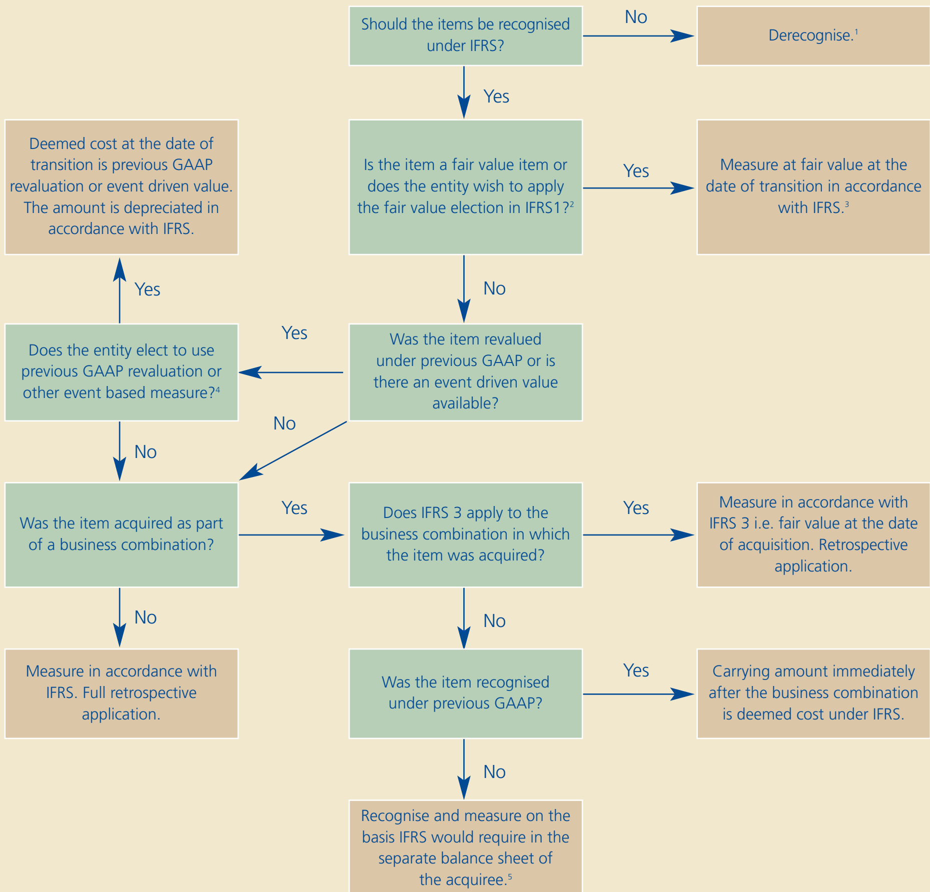
	Dr	Cr
Dr. Revaluation reserve [6 500 – 5 000]	1 500	
Cr. Shipping vessel		1 500

Reversal of original revaluation at 1 January 2003

	Dr	Cr
Dr. Accumulated depreciation [1 500 x 1/10]	150	
Cr. Retained earnings		150

Reversal of additional depreciation arising on revaluation

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



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

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

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

[4] This option is only available if the entity has, in the past, revalued items of property, plant and equipment and the revaluation was broadly comparable to fair value or cost adjusted for changes in prices. An entity may also elect to use an event driven value if that value was based on fair value. If the entity elects this option, the carrying amount is deemed cost at revaluation date depreciated in accordance with IFRS to the date of transition.

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

IFRS 1, Appendix B2 – Property, plant and equipment and investment property **not** recognised under previous GAAP

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

Retrospective application of IFRS 3

If a first-time adopter elects to apply IFRS 3 retrospectively an item of property plant and equipment or investment property should be measured in accordance with that standard from the date of acquisition.

J. Impairment of assets

Relevant IFRS: IAS 36 **Impairment of Assets**

IAS 36 as revised in March 2004 requires an impairment test to be conducted in some cases annually and in other cases when an indication exists that an asset may be impaired. An impairment loss is recognised in profit or loss when an asset's recoverable amount is less than its carrying value. Recoverable amount is the lower of an asset's fair value less cost to sell and its value in use.

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

- perform an impairment test on goodwill and intangible assets with indefinite useful lives regardless of whether an indication of impairment exists;
- determine whether an indication exists that other assets, groups of assets or cash-generating units are impaired at the date of transition;
- perform an impairment test on these assets, groups of assets or cash-generating units;
- recognise any impairment losses in retained earnings; and
- reverse any impairment losses that no longer exist at that date except for previously recognised impairment losses on goodwill.

Impairment testing is generally performed on individual assets (e.g. intangible assets, property, plant and equipment, investment property measured under the cost model in IAS 40, finance lease assets and investments in associates and joint ventures), however in many circumstances it is impracticable to determine the recoverable amount of an individual asset because it does not generate cash flows that are largely independent from other assets of the first-time adopter. In those circumstances the impairment test is conducted on the group of assets or cash-generating unit to which the individual asset belongs.

Determination of cash-generating units

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

Further the revised IAS 36 requires that cash-generating units shall:

(i) represent the lowest level within the group at which the goodwill is monitored for internal management purposes; and

(ii) not be larger than a segment as determined under IAS 14 **Segment Reporting**.

Goodwill

Goodwill allocated to the identified cash-generating units shall be tested for impairment at the date of transition (and subsequently annually) regardless of whether or not there is an indication that it may be impaired. In terms of IAS 36, goodwill is allocated to identified cash generating units that represent the lowest level at which goodwill is monitored by management and is not larger than a segment in terms of IAS 14 **Segment Reporting**. Measurement of impairment losses shall be based on the same estimates applied under previous GAAP unless there is objective evidence that those estimates were incorrect or not in accordance with IFRS. Under IFRS 3 goodwill is not amortised, but is tested for impairment on an annual basis.

Intangible assets with indefinite useful lives

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

Impairment losses

A first-time adopter shall recognise any impairment losses arising on transition to IFRS as a result of changes in accounting policies in retained earnings at the date of transition (e.g. 1 January 2004 when presenting its first IFRS financial statements for the calendar year 2005). If a first-time adopter made a valid IFRS compliant estimate of an impairment loss under previous GAAP it shall not recognise any additional impairment losses nor reverse any previously recognised impairment losses. Subsequent impairment losses or reversals of impairment losses, including losses recognised prior to transition shall be recognised in profit or loss in accordance with IAS 36.

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

K. Borrowing costs

Relevant IFRS: IAS 23 **Borrowing Costs**

IAS 23 permits two alternative accounting treatments for borrowing costs. An entity may elect as its accounting policy to a) expense all borrowing costs in the period in which they are incurred or b) capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset and expense other borrowing costs not meeting this criteria. However, in order to ensure consistency, once an entity has adopted a policy of capitalising borrowing costs, it shall apply this policy consistently and capitalise borrowing costs related to all qualifying assets.

The capitalisation of borrowing costs should commence when i) expenditures for the asset are being incurred; ii) borrowing costs are being incurred; and iii) activities that are necessary to prepare the asset for its intended use or sale are in progress, and shall cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. However, capitalisation shall be suspended during extended periods in which active development is interrupted. If capitalising borrowing costs means that the carrying amount of an asset exceeds its recoverable amount it must be written down.

There are no exceptions or exemptions in IFRS 1 regarding borrowing costs, and thus the general principle in IFRS 1 of retrospective application of IFRS effective at the reporting date applies to borrowing costs. Therefore, an entity is not permitted to capitalise borrowing costs prospectively from the date of transition.

At the date of transition, a first-time adopter shall elect whether or not to capitalise borrowing costs and apply the elected treatment consistently to all borrowing costs incurred on qualifying assets retrospectively. If the entity elects to capitalise borrowing costs it cannot subsequently change the accounting policy, unless it meets the criteria in IAS 8 for a change in accounting policy.

If a first-time adopter did not capitalise borrowing costs under previous GAAP it will probably be very difficult and even impracticable to do so retrospectively, as this involves identifying actual borrowing costs incurred many years ago on the construction of assets with long lives such as office buildings, ships, infrastructure assets etc.

Even if the entity, under previous GAAP, capitalised borrowing costs on all assets meeting the definition in IAS 23 of qualifying assets, there might be differences between previous GAAP and IAS 23 as to the measurement of borrowing costs to be capitalised. For example, IAS 23 requires investment income earned on funds temporarily invested pending their expenditure on qualifying assets to be deducted from the borrowing costs incurred, which is not common in some jurisdictions.

The first-time adopter shall analyse all borrowing costs actually capitalised under previous GAAP and if the borrowing costs initially recognised were not measured in accordance with IAS 23, the entity shall either adjust the capitalised borrowing costs as from the date of initial recognition (if the entity adopts a policy of capitalising borrowing costs) or derecognise all borrowing costs capitalised and expense all future borrowing costs in the period in which they are incurred (if the entity chooses to expense all borrowing costs).

A first-time adopter may elect to measure an item of property, plant and equipment, investment property or intangible asset at fair value or revalued amount at the date of transition. If an entity elects to capitalise borrowing costs retrospectively and measure the item at fair value, it is not permitted to capitalise any borrowing costs related to that item that were incurred before the date of the valuation.

L. Leases

Relevant IFRS: IAS 17 **Leases**
SIC 15 **Operating Leases – Incentives**

At the date of transition, a lessee or lessor classifies leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease under IAS 17. The present value of the minimum lease payments under finance leases is calculated using the rate implicit in the lease and capitalised. Lease payments made under operating leases are recognised by the lessee in profit or loss as incurred.

The optional exemption in IFRS 1 that permits a first-time adopter to measure items of property, plant and equipment, investment property and intangible assets at fair value applies to such items capitalised in the financial statements under a finance lease. A first-time adopter may therefore measure these items at fair value at the date of transition. However, the finance lease liability shall not be measured at fair value and shall be recognised at the net present value of the lease payments (i.e. amortised cost in terms of IAS 39).

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

Illustration Z – Finance lease not capitalised under previous GAAP

Company Z (the lessee) entered into a three-year lease agreement on 1 January 2003. The lease rental is $5 000 per annum. Company Z has guaranteed a $1 000 residual value at 31 December 2005 to the lessor. The leased asset is expected to have a $100 residual value at the end of the lease term. The fair value of the asset at the date it was acquired by the lessee was $13 186. The rate implicit in the lease is therefore 10%. Under previous GAAP, the lease rentals were expensed as incurred, however the lease is classified as finance lease under IFRS. Company Z has a date of transition of 1 January 2004.

Amortisation of the lease obligation:

Date	Lease rental	Interest expense	Reduction in lease obligation	Lease obligation
1 January 2003				13 186
31 December 2003	5 000	1 319	3 681	9 505
31 December 2004	5 000	1 951	4 049	5 455
31 December 2005	5 000	546	4 454	1 000

Depreciation (13 186 – 100) / 3 = 4 362 per year

The following journal entries are required at the date of transition 1 January 2004:

	Dr.	Cr.
Dr. Finance lease asset	13 186	
Dr. Retained earnings	681	
Cr. Accumulated depreciation (1 year)		4 362
Cr. Liability under finance lease		9 505

In some cases, the lessee and the lessor may agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification under IAS 17 had the changed terms been in effect at the inception of the lease. If so, the revised agreement is considered as a new agreement over its term. However, changes in estimates (for example, changes in estimates of the useful life or of the residual value of the leased property) or changes in circumstances (for example, default by the lessee) do not give rise to a new classification of a lease.

M. Inventories

Relevant IFRS: IAS 2 **Inventories**

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

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

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

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

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

N. Construction contracts

Relevant IFRS: IAS 11 **Construction Contracts**

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

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

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

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

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

Illustration AA – Construction contract not recognised under previous GAAP

Company AA is a first-time adopter with a date of transition of 1 January 2004. Company AA did not, under previous GAAP, recognise construction contracts on the percentage of completion method. Company AA entered into a fixed price contract on 1 January 2003 to build a bridge for a price of €9 000. The contractor's estimate of total contract costs is €8 050 at 1 January 2004. It will take 3 years to build the bridge. The costs incurred up to the date of transition are €2 343 including €250 relating to raw materials on site. Company AA invoices the customer based on work certified which was €3 000 in 2003. Under previous GAAP, Company AA recognised an expense of 2 400 and revenue of 3 000 in profit or loss.

The contractor determines the percentage of completion of the contract by calculating the proportion that contract costs incurred for work performed to the date of transition to IFRS bear to the latest estimated total contract costs. The costs incurred to date on the contract exclude the €250 related to raw materials because this expense has not yet been incurred on the project. The percentage of completion is therefore 26% [(2 343 – 250) / 8 050]

The following journal entries are required at the date of transition:

Dr. Retained earnings	660	
Cr. Construction work in progress		660
[3 000 – (9 000 x 26%)]		
Adjustment to revenue recognised in terms of the contract		

Dr. Construction work in progress	307	
Cr. Retained earnings		307
[2 400 – (8 050 x 26%)]		
Reversal of excess cost recognised in profit or loss		

O. Provisions

Relevant IFRS: IAS 37 **Provisions, Contingent Liabilities and Contingent Assets**
IFRIC 1 **Changes in Existing Decommissioning, Restoration and Similar Liabilities**

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

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

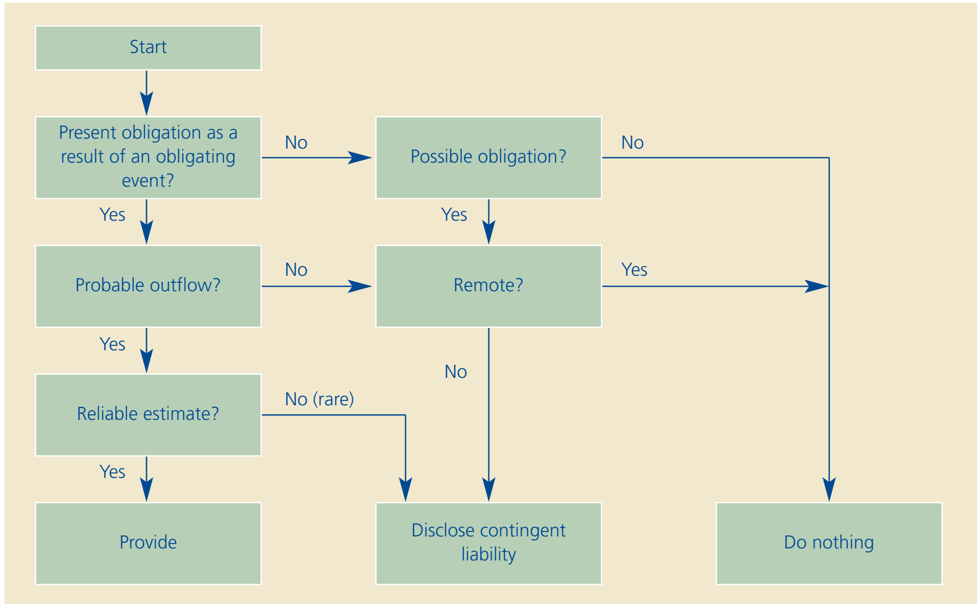
(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

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

No provision is permitted if all these conditions are not met; neither in the opening IFRS balance sheet nor subsequent to the date of transition.

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

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



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

There are no exceptions or exemptions in IFRS 1 regarding provisions, and thus the general principle in IFRS 1 of retrospective application of the standards effective at the reporting date applies to provisions.

Therefore, at the date of transition, the first-time adopter shall analyse any provisions recognised under previous GAAP and assess whether they meet the recognition criteria according to IAS 37 described above. If provisions recognised under previous GAAP do not meet these criteria, e.g. because the entity does not have a present obligation, they shall be removed from the opening IFRS balance sheet with a corresponding adjustment to retained earnings at the date of transition.

Likewise, if the first-time adopter has incurred liabilities meeting the recognition criteria for provisions, but for which no provision was recognised under previous GAAP, a provision shall be recognised in the opening IFRS balance sheet measured in accordance with IAS 37 at the date of transition, with a corresponding adjustment to retained earnings.

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

Special criteria for recognising restructuring provisions

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

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

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

Assumed in a business combination

Retrospective application of IFRS 3

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

Such provision is measured again at the date of transition, and any change in the provision from the date of acquisition until the date of transition is adjusted against retained earnings.

Furthermore retrospective application of IFRS could involve recognising contingent liabilities at the date of acquisition as part of allocating the cost of the business combination, with a corresponding adjustment to goodwill. Contingent liabilities do not meet the recognition criteria relating to provisions and as such would not have been recognised outside a business combination. However, any contingent liabilities recognised in the opening IFRS balance sheet due to the first-time adopter applying IFRS 3 retrospectively to business combinations prior to the date of transition shall remain in the opening IFRS balance sheet measured at the highest of:

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

(b) the amount recognised as part of allocating the cost of the business combination in question, being the amount that a third party would charge to assume those contingent liabilities at the date of the business combination.

The contingent liability remains in the balance sheet until it is settled or it becomes remote that an outflow of resources will be required to settle the obligation. In the latter case, the provision is reversed in profit or loss.

IFRS 1, Appendix B2 – Provisions assumed in a business combination

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

No adjustments are made to the allocation of the cost of the acquisition to identifiable assets and liabilities and thus to goodwill calculated at the date of acquisition. Even if the goodwill was increased at the date of the acquisition due to the recognition of a provision that did not qualify for recognition under IFRS, e.g. a restructuring provision, the removal of the provision from the opening IFRS balance sheet at the date of transition is adjusted against retained earnings and not goodwill. However, goodwill is always tested for impairment, and may therefore be written down anyway with a corresponding adjustment to retained earnings at the date of transition.

Illustration AB – Provision assumed in a business combination not recognised under previous GAAP

Company AB acquired Subsidiary B on 1 January 2001. At that date Subsidiary B had issued warranties with a best estimate of the resources required to settle the obligation at that date of acquisition of £200. The liability was not recognised as a provision by Subsidiary B or as part of allocating the cost of the business combination under previous GAAP in the consolidated financial statements of Company AB. At the date of transition (1 January 2004) the best estimate of resources required to settle the warranty liability at that date is £125. The treatment of the provision in the opening IFRS balance sheet depends on whether Company AB applies IFRS 3 or the exemption under IFRS 1, Appendix B2 to the acquisition of Company B. The following journal entries are required in each instance:

Application of IFRS 3 retrospectively

	Dr	Cr
Dr. Goodwill	200	
Cr. Provision (at the date of acquisition)		200
Dr. Provision (re-measurement at the date of transition)	75	
Cr. Retained earnings		75

Application of IFRS 1, Appendix B2 exemption

	Dr	Cr
Dr. Retained earnings	125	
Cr. Provision (at the date of transition)		125

P. Income taxes

Relevant IFRS: IAS 12 **Income Taxes**

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

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

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

(a) the initial recognition of goodwill; or

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

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

  (i) is not a business combination; and

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

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

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

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

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

Illustration AC – Recognition of deferred tax on first-time adoption

At the date of transition, a first-time adopter recognises and measures assets and liabilities in accordance with IFRS 1. At the same date it determines the tax bases of all those assets and liabilities. If a temporary difference arose on the initial recognition of the asset or the liability in a transaction that was neither a business combination nor affected accounting and taxable profit, the initial recognition exemption applies and the tax asset or liability is not recognised.

In all other cases, the requirements of IFRS 1 to recognise deferred tax shall be applied. Therefore the initial recognition exemption in IAS 12 shall not apply to temporary differences that arise on first-time adoption adjustments unless the exemption would have applied if the item was recognised previously.

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

IV. Questions and responses – Implementation

Question comparative information:	Date of adoption
Question estimates:	Correction of an error that occurred prior to the date of transition to IFRS.
Question A1:	Step acquisition completed prior to the date of transition to IFRS.
Question A2:	Definition of a business combination for the exemption.
Question A3:	Restatement of an acquisition of an associate that would have been consolidated under IFRS.
Question D1:	Effect on employee benefit exemption when a parent and subsidiary have different dates of transition to IFRS.
Question E1:	Fair value hedge under local GAAP that does not qualify as a fair value hedge under IFRS.
Question E2:	Hedge of a forecasted transaction.
Question E3:	Change in policy to measure impairment of financial assets.
Question F1:	Subsidiary applies IAS 19 prior to other plans in the consolidated accounts.
Question H1:	Restatement of an asset as a result of prior impairments or other requirements not in accordance with IFRS.
Question H2:	Capitalisation of costs incurred prior to the date of transition on internally developed intangible assets.
Question I1:	Reclassification of revaluation reserves.
Question I2:	Broadly comparable to fair value.

Question comparative information: Date of adoption

Question

Company X is adopting IFRS for the first-time with a date of transition of 1 June 2004 and a reporting date of 30 May 2006. When is the date of adoption as referred to in IFRS 1, paragraph 36A?

Response

"Date of adoption" is not explicitly defined in IFRS 1. However, since IFRS 1, paragraph 36A does not refer to "date of transition" nor to "reporting date" (both defined terms in IFRS 1), it shall mean "the beginning of the period for which an entity presents its first IFRS financial statements" i.e. 1 June 2005. Therefore, Company X does not need to restate its comparative information to comply with IAS 32, IAS 39 and IFRS 4 as it adopts IFRS before 1 January 2006.

Question estimates: Correction of an error that occurred prior to the date of transition to IFRS

Question

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

Response

If estimates were in error prior to the date of transition, the impacts of the correction of the error in estimates shall be adjusted in retained earnings of the opening IFRS balance sheet in the same manner as corrections to the opening IFRS balance sheet due to changes in accounting policies from previous GAAP to IFRS. However, in the reconciliation according to IFRS 1, paragraph 39 of equity and the income statement previously reported to equity and the income statement under IFRS for the same periods, the corrections of errors shall be disclosed separately from the effects of changes in accounting policies. This disclosure shall be on a gross basis – that is, presentation of net errors is not allowed.

Question A1: Step acquisition completed prior to the date of transition to IFRS

Facts

Company C acquired Subsidiary T in stages beginning with a 10 percent acquisition on 30 June 2002, 30 percent on 31 December 2002, and 20 percent on 31 December 2003. It was determined that Company C obtained control of Subsidiary T on 31 December 2003. Company C is a first-time adopter with 1 January 2004 as its date of transition to IFRS. Company C has elected to restate all business combinations after 1 January 2003.

Question

How does this election apply to the step acquisitions prior to 1 January 2003?

Response

In this example, the date of acquisition of a subsidiary is 31 December 2003. Consequently, Company C shall also restate each step in the acquisition process, back to the first acquisition of 10 percent on 30 June 2002. Since the election is based on the date of acquisition of a subsidiary, the restatement of the first step would not affect the date from which all combinations shall be restated. Therefore, in the above example, restatement is not required for any other business combination prior to 1 January 2003.

Question A2: Definition of a business combination for the exemption

Facts

In some countries, certain transactions that would be considered a business combination under IFRS 3, Business Combinations, were not considered a business combination under local accounting standards.

Question

Does a transaction have to be accounted for as a business combination under national accounting standards to qualify for the exemption in IFRS 1?

Response

The determination of whether a transaction qualifies for the business combination exemption depends on whether that combination meets the definition of a business combination under IFRS. If the transaction meets the definition of a business combination under IFRS (regardless of whether it met that definition under local accounting standards), the exemption for business combinations in IFRS 1 would be permitted for that transaction.

Question A3: Restatement of an acquisition of an associate that would have been consolidated under IFRS

Facts

Company N acquired 48 percent of Company U on 1 January 2002. Under local GAAP, Company N appropriately did not consolidate Company U and accounted for its investment in Company U as an associate under the equity method of accounting. Company N is adopting IFRS with a date of transition of 1 January 2004. Company N has determined that under IAS 27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries, Company N has control of Company U since the date of acquisition.

Question

Should this acquisition be restated under IFRS 1 as if the entity has always been consolidated?

Response

The steps involved with accounting for the acquisition of an associate are similar to that of a business combination in that goodwill is determined. Additionally, the equity method is, in essence, a one-line consolidation, and therefore, changes in equity are accounted for from the date of acquisition. It would not be appropriate to restate goodwill and the balance of the investment in the associate under IFRS 1, Appendix B2 (j), unless Company N decides to restate all business combinations that occurred on or after 1 January 2002.

Upon first-time adoption (if Company N chooses not to restate the acquisition of Company U), the carrying amounts of the assets (including goodwill) and liabilities would be accounted for under the requirements of IFRS 1.

Question D1: Effect on employee benefit exemption when a parent and subsidiary have different dates of transition to IFRS

Facts
Subsidiary S is a publicly listed entity in Europe and a subsidiary of Company P. Subsidiary S adopted IFRS in 2005, using 1 January 2004 as its date of transition. Upon first-time adoption, Subsidiary S elected to reset its corridor to zero in accordance with IFRS 1.20 through retained earnings. Company P is adopting IFRS in 2008, using 1 January 2007 as its date of transition.

Question
Can Company P elect to reset Subsidiary S's pension corridor to zero in 2007 when Company P first adopts IFRS?

Response
No. If a parent adopts IFRS later than its subsidiary, it shall use the subsidiary's date of transition as its own for that subsidiary in accordance with IFRS 1 paragraph 25.

Question E1: Fair value hedge under local GAAP that does not qualify as a fair value hedge under IFRS

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

Question
How should the previous fair value adjustments to the carrying amount of the hedged item be accounted for on first-time adoption of IFRS, and thereby, the initial application of IAS 39?

Response
No adjustment is required in the opening IFRS balance sheet. However, in accordance with IAS 39 any previous adjustment to the carrying amount of the hedged item shall be amortised to profit or loss (IAS 39 paragraph 92) over the remaining life of the debt instrument. Therefore, the opening balance of retained earnings shall not be adjusted for this item.

Entities that have a date of adoption before 1 January 2006 are not required to apply IAS 39 to the comparative information. Therefore, if Company H is adopting IFRS with a reporting date of 31 December 2005 and thus a date of transition of 1 January 2004, 1 January 2005 would be the date from which the adjustment shall be amortised to profit or loss.

Question E2: Hedge of a forecasted transaction

Question

If a forecasted transaction does not, at the date of transition to IFRS, meet the "highly probable" criterion of IAS 39 paragraph 88(c), how should any net cumulative gains or losses arising on measurement at fair value of the hedging instrument be accounted for at the date of transition?

Response

The response depends on whether or not the forecasted transaction is still expected to occur, even though it is not "highly probable". Furthermore, the response depends on how the hedging instrument and changes in its fair values was treated under previous GAAP.

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

If, at the date of transition to IFRS, the forecasted transaction is not highly probable but is still expected to occur, the cumulative gain or loss on the hedging instrument that was reported directly in equity, under previous GAAP, is reclassified/remains as a separate component of equity on the date of transition to IFRS, and shall remain separately in equity until the forecasted transaction occurs, in accordance with IAS 39, paragraph 101(b). Subsequently, in the event that the forecasted transaction is no longer expected to occur, any related net cumulative gain or loss, reclassified as a separate component of equity on the date of transition to IFRS, shall be reported in profit or loss in accordance with IAS 39, paragraph 101(c).

If, at the date of transition to IFRS, the forecasted transaction is not highly probable and is not expected to occur, the cumulative gain or loss on the hedging instrument that was reported directly in equity under previous GAAP shall be reclassified to retained earnings at the date of transition in accordance with IFRS 1, paragraph11.

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

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

If the derivative instrument was carried at an amount other than fair value with a deferred debit or credit in the balance sheet recorded as an offset, that deferred debit or credit shall be reversed through retained earnings if it does not meet the appropriate recognition criteria under IFRS. Additionally, the adjustment of the derivative instrument to fair value shall also be recognised in the adjustment to retained earnings.

Entities that have a date of adoption before 1 January 2006 are not required to apply IAS 39 to the comparative information. Therefore, a first time adopter with a reporting date of 31 December 2005 and thus a date of transition of 1 January 2004 may elect to measure and recognise the above adjustments as of 1 January 2005 and not at date of transition.

Question E3: Change in policy to measure impairment of financial assets

Facts

Under local GAAP, Company A measured impairment of financial assets carried at cost on an undiscounted basis. IAS 39 **Financial Instruments: Recognition and Measurement** requires that impairment be measured on a discounted basis (IAS 39 paragraph 66). Therefore, at the date of transition to IFRS (e.g. 1 January 2004), Company A makes an adjustment to the carrying amount of those financial assets that are measured at amortised cost under IAS 39 to reflect the effect of discounting expected future cash flows.

Question

Shall this adjustment be recognised as an adjustment to the opening balance of retained earnings at the date of transition in accordance with IFRS 1?

Response

Yes. Under IFRS 1.11, IFRS 1.31 and IFRS 1, IG58, Enterprise A shall recognise this measurement adjustment as a change in accounting policies for impairments of financial assets (e.g., loans) directly in retained earnings at the date of transition (1 January 2004).

However, entities that have a date of adoption before 1 January 2006 are not required to apply IAS 39 to the comparative information. Therefore, a first time adopter with a reporting date of 31 December 2005 and thus a date of transition of 1 January 2004, may elect to measure and recognise the above adjustments as of 1 January 2005 and not at date of transition.

Question F1: Subsidiary applies IAS 19 prior to other plans in the consolidated accounts

Facts

Company N acquires Subsidiary U on 1 January 2002. Subsidiary U has adopted IFRS prior to the date of acquisition and continues to apply IFRS prospectively for local reporting purposes. Company U has a defined benefit plan accounted for under IAS 19 **Employee Benefits**. On 31 December 2007, Company N adopts IFRS (with a date of transition of 1 January 2006).

Question

May Company N reset the pension corridor for all of its plans, except for those plans currently applying IAS 19?

Response

Yes. IFRS 1.20 states that if a first-time adopter chooses to reset the pension corridor to zero, that election shall apply to all its plans. However, as Subsidiary U became a first-time adopter before company N, IFRS 1.25 requires Company N, in its consolidated financial statements, to measure the assets and liabilities of Subsidiary U at the same carrying amounts as in Subsidiary U's IFRS financial statements. As a result, Company N shall account for the pension plan already accounted for in accordance with IAS 19 at its current carrying amount, regardless of whether the corridor in the other plans is reset to zero.

Question H1: Restatement of an asset as a result of prior impairments or other requirements not in accordance with IFRS

Facts
Company N acquired Subsidiary U on 1 January 2002. As part of the purchase price allocation, €100 was allocated to purchased in-process research and development (IPR&D). In accordance with local accounting standards, this amount was expensed immediately in the combined entity's income statement. Company N is adopting IFRS with a 1 January 2004 date of transition.

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

Response
Yes. IFRS 1 requires the use of IFRS compliant accounting policies in the opening IFRS balance sheet and throughout the periods presented. IFRS 1, IG51 states that if an entity has chosen a policy of amortisation that does not comply with IFRS, that intangible asset shall be restated as if an IFRS compliant amortisation method was used. The immediate impairment or write-off of IPR&D is not in accordance with IFRS, and therefore, shall be reversed and amortisation appropriately recognised.

Since this impairment or write-off of IPR&D occurred outside of the business combination, the exemption in IFRS 1.15 for a business combination would not apply. This requirement also applies to the recognition and impairment of other impairment losses and reversals recorded in prior periods for assets with continuing useful lives at the date of transition.

Question H2: Capitalisation of costs incurred prior to the date of transition on internally developed intangible assets

Facts
Company A is adopting IFRS with a date of transition of 1 January 2004. At Company A's date of transition, certain internal development projects were determined to be in the development phase in accordance with IAS 38, Intangible Assets.

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

Response
If Company A can reliably measure the development costs incurred, then recognition of the asset is required. However, IFRS 1 recognises that in many cases where prior cost data was not reliably segregated between research and development, for example, then measurement of the development costs may not be reliable and consequently an asset shall not be recognised.
If measurement can be determined reliably from the date the recognition criteria were met, then restatement of the asset would be as if IAS 38 had been applied. That is, only costs incurred during the development phase shall be capitalised in the opening IFRS balance sheet at 1 January 2004.

Question I1: Reclassification of revaluation reserves

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

Question
How should the entity recognise the revaluation amount in equity under Company G's local GAAP at the date of transition to IFRS?

Response
IFRS 1, paragraph 11 requires the adjustments arising from first-time adoption to be recognised in retained earnings, or if appropriate, another category of equity. If an entity recognises the property, plant and equipment at its revalued amount as deemed cost, the adjustment is recorded in retained earnings or a separate category of equity and not included in the revaluation reserve. Therefore, a subsequent impairment cannot be recognised against the revaluation reserve, but instead shall be charged to the income statement.

Question I2: Broadly comparable to fair value

Question
Company K under local GAAP has an option to fair value property, plant and equipment at 80 percent of the fair value. Is this amount broadly comparable to fair value?

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

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

Appendix A – Illustrative reconciliation

Adoption of IFRS in 2005

The accounting policies were changed on 1 January 2005 to comply with IFRS. The transition to IFRS is accounted for in accordance with IFRS 1 First-time Adoption of International Financial Reporting Standards, with 1 January 2004 as the date of transition. The changes in accounting policies as a consequence of the transition to IFRS are described below, and the reconciliations of the effects of the transition to IFRS are presented in the notes to the first IFRS financial statements.

The transition to IFRS resulted in the following changes in accounting policies:

a. Development costs are recognised as an intangible asset – when certain criteria are met – and measured at cost less accumulated amortisation. Amortisation commences when the asset is available for use. Under previous GAAP development costs were recognised as an expense as incurred. The effect of the change is an increase in equity at 31 December 2004 of €1,721million (€1,439 million at 1 January 2004) and an increase in profit before tax for 2004 of €403 million (€282 million after tax)

b. Financial liabilities except derivatives are measured at amortised cost. Under previous GAAP financial liabilities were measured at nominal value and any difference between the initial amount and the maturity amount at the date the liability was incurred were recognised in profit or loss. The effect of the change is an increase in equity at 31 December 2004 of €890 million (€984 million at 1 January 2004) and a decrease in profit before tax for 2004 of €133 million (€93 million after tax).

c. Derivative financial instruments are initially recognised at cost and subsequently measured at fair value. Changes in fair value of derivative financial instruments designated as hedging instruments and meeting the criteria for hedging future cash flows are recognised directly in equity, for their effective portion, and reclassified into profit or loss in the same period during which the hedged forecast transaction affects profit or loss. Under previous GAAP derivatives hedging future cash flows were not recognised. The effect of the change is a decrease in equity at 31 December 2004 of €238 million (€309 million as of 1 January 2004). The change does not affect profit or loss for 2004.

d. Dividends to shareholders declared after the balance sheet date but before the financial statements are authorised for issue are not recognised as a liability at the balance sheet date but disclosed separately in the notes. Under previous GAAP dividends for the accounting year were recognised as a liability. The effect of the change is an increase in equity at 31 December 2004 of €1,824 million (€1,568 million as of 1 January 2004). The changes does not affect profit or loss for 2004.

e. Inventories are measured at the lower of cost and net realisable value. Cost include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Under previous GAAP production overheads were not included in the cost of inventories. The effect of the change is an increase in equity at 31 December 2004 of €1,100 million (€900 million as of 1 January 2004) and an increase in profit before tax for 2004 of €285 million (€200 million after tax).

f. Goodwill is not amortised but measured at cost less impairment losses. Under previous GAAP goodwill was amortised on a straight-line basis in profit or loss based on an individual assessment of the economic life of the asset, however, with a maximum of 20 years. The effect of the change is an increase in equity at 31 December 2004 of €730 million and an increase in profit before tax for 2004 of 730. The change does not affect equity at 1 January 2004. The change has no tax effect as deferred taxes are not recognised for temporary differences arising from goodwill for which amortisation is not deductible for tax purposes.

g. Under previous GAAP a restructuring provision relating to a production site was recognised. Under IFRS this provision does not qualify for recognition as a liability, neither at 1 January 2004 nor 31 December 2004. The effect of the change is an increase in equity at 31 December 2004 of €1 526 million (€700 million as of 1 January 2004) and an increase of profit before tax for 2004 of €1 180 million (€826 million after tax).

h. The above changes increased the deferred tax liability as follows:

	1 Januaury 2004	**31 December 2004**
Recognition of development cost (a)	617	737
Recognition of derivatives (b)	422	382
Production overheads included in cost of inventories (e)	386	471
Restructuring provision derecognised	300	654
Total	**1,725**	**2,244**

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

Effect of IFRS adoption on the balance sheet

EUR million	Note	As at 01.01.2004 (date of transition) Previous GAAP	Effect of transition to IFRSs	IFRS (Opening IFRS balance sheet)	As at 31.12.2004 (End of last period presented under previous GAAP) Previous GAAP	Effect of transition to IFRSs	IFRS
Property, plant and equipment		75,973		75,973	96,680		96,680
Goodwill	f	1,567		1,567	5,504	730	6,234
Intangible assets	a	200	2,056	2,256	943	2,458	3,401
Financial assets		2,680		2,680	4,065		4,065
TOTAL NON-CURRENT ASSETS		**80,420**	**2,056**	**82,476**	**107,192**	**3,188**	**110,380**
Trade and other receivables		12,943		12,943	14,630		14,630
Inventories	e	6,868	1,286	8,154	12,270	1,571	13,841
Other receivables		4,711		4,711	4,953		4,953
Long-term bonds held for sale		7,158		7,158	3,902		3,902
Cash and cash equivalents		13,959	–	13,959	19,567		19,567
TOTAL CURRENT ASSETS		**45,639**	**1,286**	**46,925**	**55,322**	**1,571**	**56,893**
TOTAL ASSETS		**126,059**	**3,342**	**129,401**	**162,514**	**4,759**	**167,273**
Interest-bearing loans	b	36,111	(1,405)	34,706	59,887	(1,272)	58,615
Trade and other payables	c	9,574	309	9,883	10,045	238	10,283
Employee benefits		–		–			–
Restructuring provision	g	1,000	(1,000)	–	2,180	(2,180)	–
Dividend to shareholders	d	1,568	(1,568)	–	1,824	(1,824)	–
Current tax liability		1,053		1,053	962		962
Deferred tax liability	h	2,384	1,725	4,109	4,855	2,244	7,099
TOTAL LIABILITIES		**51,690**	**(1,939)**	**49,751**	**79,753**	**(2,794)**	**76,959**
TOTAL ASSETS LESS TOTAL LIABILITIES		**74,369**	**5,281**	**79,650**	**82,761**	**7,553**	**90,314**
Issued capital		22,800		22,800	22,800		22,800
Share premium		16,559		16,559	16,559		16,559
Revaluation reserve		1,313		1,313	1,899		1,899
Hedging reserve	c	–	(309)	(309)		(238)	(238)
Retained earnings	a,b,d,e,f	33,697	5,590	39,287	41,503	7,791	49,294
TOTAL EQUITY		**74,369**	**5,281**	**79,650**	**82,761**	**7,553**	**90,314**

		01.01.2004	31.12.2004
Total equity previous GAAP		**74,369**	**82,761**
Recognition of development costs less amortisation	a	2,056	2,458
Loans measured at amortised cost not nominal value	b	1,405	1,272
Derivatives recognised and measured at fair value	c	(309)	(238)
Dividend not recognised as liability until declared	d	1,568	1,824
Production overheads in cost of inventories	e	1,286	1,571
Goodwill not amortised after date of transition	f	–	730
Derecognition of restructuring provision	g	1,000	2,180
		7,006	9,797
Tax effect of the above	e	(1,725)	(2,244)
Total adjustment to equity		**5,281**	**7,553**
Total equity IFRS		**79,650**	**90,314**

EUR million	Note	2004 (the latest period presented under previous GAAP) Previous GAAP	Effect of transition to IFRS	IFRS
Revenue		123,531	–	123,531
Cost of sales	a,e,g	(75,982)	1,278	(74,704)
GROSS PROFIT		**47,549**	**1,278**	**48,827**
Other income		1,476		1,476
Distribution costs	f,g	(19,406)	1,025	(18,381)
Administrative expenses	g	(11,178)	295	(10,883)
Other expenses		(477)		(477)
OPERATING PROFIT		**17,964**	**2,598**	**20,562**
Share of profit in associates before tax		943		943
Finance costs (net)	b	(2,870)	(133)	(3,003)
PROFIT BEFORE TAX		**16,037**	**2,465**	**18,502**
Income taxes		(5,481)	(520)	(6,001)
PROFIT FOR THE PERIOD		**10,556**	**1,945**	**12,501**
Earnings per share		0.463		0.548

		Operating profit (1)	Profit before tax (1)	Profit for the period (2)
Profit previous GAAP		**17,964**	**16,037**	**10,556**
Recognition of development costs less amortisation	a	403	403	282
Loans measured at amortised cost instead of nominal value	b		(133)	(93)
Production overheads in cost of inventories	e	285	285	200
Goodwill no longer amortised as from the date of transition	f	730	730	730
Restructuring provision not recognised as a liability	g	1,180	1,180	826
Total adjustment to Profit or Loss		**2,598**	**2,465**	**1,945**
Profit IFRS		**20,562**	**18,502**	**12,501**

(1) Permitted
(2) Required

Effect of IFRS adoption for the cash flow statement

EUR million	Note	Previous GAAP	Effect of transition to IFRS	IFRS
		2004 (the latest period presented under previous GAAP)		
Cash flow from operating activities		21,858		21,858
Cash flow from investing activities	i	(33,520)	2,603	(30,917)
		(11,662)	**2,603**	**(9,059)**
Cash flow from financing activities	i	14,163		14,163
Net increase (decrease) in cash and cash equivalents		**2,501**	**2,603**	**5,104**
Cash and cash equivalents at beginning of period	**i**	**21,120**	**(6,441)**	**14,679**
Cash and cash equivalents at end of period	**i**	**23,621**	**(3,838)**	**19,783**

	01.01.2004	31.12.2004
Cash and cash equivalents consists of:		
Long-term bonds with a maturity of less than three months	717	216
Cash and cash equivalents	13,962	19,567
	14,679	19,783
Long-term bonds consists of:		
Long-term bonds with a maturity of less than three months	717	216
Long-term bonds with a maturity above three months	6,441	3,686
	7,158	3,902

Appendix B – Table of implications by line item

<table>
<tr><th rowspan="4">Balance sheet line item</th><th colspan="3">Acquired as Part of a Business Combination?</th></tr>
<tr><th colspan="2">Yes</th><th rowspan="3">No</th></tr>
<tr><th>Before date of transition (or earlier selected date) – Application of IFRS 1 Appendix B</th><th>After date of transition (or earlier selected date) – Retrospective application of IFRS 3</th></tr>
<tr><th colspan="2">All business combinations after the earliest selected application date must be accounted for in terms of IFRS 3</th></tr>
<tr><td>"GENERAL PRINCIPLES

(To be applied to all items except mandatory exceptions and optional exemptions detailed below)</td><td>1. Maintain the same classification of the business combination under previous GAAP.
2. Recognise all assets and liabilities at date of transition in terms of IFRS, resulting adjustments recognised in retained earnings.
3. Derecognise all items that do not qualify for recognition in terms of IFRS, resulting adjustments recognised in retained earnings.
4. Reclassify items recognised under previous GAAP to appropriate IFRS classification.
5. For fair value based items – recognise fair value at date of transition, resulting adjustments recognised in retained earnings.
6. For cost based items recognised in terms of previous GAAP – deemed cost is carrying value under previous GAAP immediately after acquisition. Only adjust depreciation if amount is materially different under IFRS.
7. For cost based items not recognised in terms of previous GAAP – deemed cost is carrying value determined on the basis that IFRS would require in the separate balance sheet of the acquiree.</td><td>1. Classify the business combination as an acquisition;
2. Measure the cost of the business combination;
3. Identify and recognise all assets and all liabilities in accordance with the IFRS, including contingent liabilities but excluding any provision for restructuring;
4. Measure the fair value of identified assets and liabilities at the date of the business combination, including minority interests;
5. Determine any goodwill or discount on acquisition;
6. Allocate any goodwill to cash generating units within the acquired business;
7. No subsequent amortisation of goodwill; and
8. Perform an impairment test at each annual reporting subsequent to the acquisition.</td><td>1. Recognise all assets and liabilities at date of transition in terms of IFRS, resulting adjustments recognised in retained earnings.
2. Derecognise all items that do not qualify for recognition in terms of IFRS, resulting adjustments recognised in retained earnings.
3. Reclassify items recognised under previous GAAP to appropriate IFRS classification.
4. Apply IFRS retrospectively in measuring all recognised assets and liabilities.</td></tr>
</table>

	Acquired as Part of a Business Combination?		
	Yes		**No**
Balance sheet line item	**Before date of transition (or earlier selected date) – Application of IFRS 1 Appendix B**	**After date of transition (or earlier selected date) – Retrospective application of IFRS 3**	
	All business combinations after the earliest selected application date must be accounted for in terms of IFRS 3		
NON-CURRENT ASSETS			
Property, plant and equipment Investment property	Election to use: 1. Fair value measured at date of transition; 2. Previous GAAP revaluation amount, provided that the amount was, at revaluation date,broadly comparable to: i. fair value; ii. cost or depreciated cost adjusted for changes in price index; OR 3. An event driven fair value measurement (e.g. IPO).	Election to use: 1. Fair value measured at date of transition; 2. Previous GAAP revaluation amount, provided that the amount was, at revaluation date,broadly comparable to: i. fair value; ii. cost or depreciated cost adjusted for changes in price index; OR 3. An event driven fair value measurement (e.g. IPO).	Election to use: 1. Fair value measured at date of transition; 2. Previous GAAP revaluation amount, provided that the amount was, at revaluation date,broadly comparable to: i. fair value; ii. cost or depreciated cost adjusted for changes in price index; OR 3. An event driven fair value measurement (e.g. IPO).
Goodwill (deducted from equity)	1. Maintain classification in equity. 2. Not recognised in profit or loss on disposal of subsidiary. 3. Subsequent adjustments as a result of contingent purchase consideration recognised in retained earnings.	1. Recognise goodwill in the opening IFRS balance sheet. 2. Adjust goodwill for fair value adjustments to identifiable assets, liabilities and contingent liabiltities (net of deferred tax) at date of acquisition. 3. Do not amortise goodwill. 4. Impairment test at date of transition and annually thereafter.	N/A
Goodwill (capitalised in the balance sheet as an asset)	Carrying amount of goodwill at date of acquisition adjusted for: 1. Intangible assets recognised under previous GAAP but not under IFRS. 2. Intangible assets not recognised under previous GAAP but under IFRS. 3. Purchase consideration contingencies resolved before the date of transition (provided reliable measure and probable payment). 4. Must perform impairment test, regardless of whether indication of impairment exists. All other adjustments to the carrying amount of goodwill are prohibited.	1. Recognise goodwill in the opening IFRS balance sheet. 2. Adjust goodwill for fair value adjustments to identifiable assets, liabilities and contingent liabiltities (net of deferred tax) at date of acquisition. 3. Do not amortise goodwill. 4. Impairment test at date of transition and annually thereafter.	N/A
Negative goodwill	Derecognise and resulting adjustment is recognised in retained earnings.	Derecognise and resulting adjustment is recognised in retained earnings.	Derecognise and resulting adjustment is recognised in retained earnings.

Balance sheet line item	Acquired as Part of a Business Combination?		
	Yes		No
	Before date of transition (or earlier selected date) – Application of IFRS 1 Appendix B	After date of transition (or earlier selected date) – Retrospective application of IFRS 3	
	All business combinations after the earliest selected application date must be accounted for in terms of IFRS 3		
NON-CURRENT ASSETS (continued)			
Intangible assets (other than goodwill)	Election to use: 1. Fair value measured at the date of transition if determined by reference to an active market; 2. Previous GAAP revaluation amount, provided that the amount was, at revaluation date,broadly comparable to: i. fair value; ii. cost or depreciated cost adjusted for changes in price index; OR 3. An event driven fair value measurement (e.g. IPO). Adjustments arising due to recognising or derecognising intangible assets are recognised in goodwill.	Refer to the general principles above.	Provided the recognition criteria in IAS 38 were satisfied when the asset was acquired. Election to use: 1. Fair value measured at date of transition if determined by reference to an active market; 2. Previous GAAP revaluation amount, provided that the amount was, at revaluation date,broadly comparable to: i. fair value; ii. cost or depreciated cost adjusted for changes in price index; OR 3. An event driven fair value measurement (e.g. IPO). Adjustments arising due to recognising or derecognising intangible assets are recognised in retained earnings.
Investments in associates	Refer to the general principles above.	Retrospective application of IAS 28.	Refer to the general principles above.
Deferred tax assets	Apply IAS 12 to temporary differences arising at the date of transition between the carrying values of assets and liabilities in the opening IFRS balance sheet and their tax bases.	Apply IAS 12 to temporary differences arising at the date of transition between the carrying values of assets and liabilities in the opening IFRS balance sheet and their tax bases.	Apply IAS 12 to temporary differences arising at the date of transition between the carrying values of assets and liabilities in the opening IFRS balance sheet and their tax bases.
CURRENT ASSETS			
Inventories, receivables, bank balances and cash, finance lease receivables and other current assets	Refer to the general principles above.	Refer to the general principles above.	Refer to general principles above.

Balance sheet line item	Acquired as Part of a Business Combination?		
	Yes		**No**
	Before date of transition (or earlier selected date) – Application of IFRS 1 Appendix B	**After date of transition (or earlier selected date) – Retrospective application of IFRS 3**	
	All business combinations after the earliest selected application date must be accounted for in terms of IFRS 3		
CURRENT ASSETS (continued)			
Financial assets – available-for-sale, held to maturity, at fair value through profit or loss, loans and receivables	**Previously derecognised financial assets and financial liabilities** Apply derecognition criteria prospectively from 1 January 2004. (may apply derecognition criteria retrospectively if information was available at the time of the transaction). **Hedge accounting** 1. Measure all derivatives at fair value. 2. Eliminate all deferred losses and gains arising on derivatives that were reported under previous GAAP as assets or liabilities. 3. Apply transitional provisions of IAS 39 to all other hedging relationships.	**Previously derecognised financial assets and financial liabilities** Apply derecognition criteria prospectively from 1 January 2004. (may apply derecognition criteria retrospectively if information was available at the time of the transaction). **Hedge accounting** 1. Measure all derivatives at fair value. 2. Eliminate all deferred losses and gains arising on derivatives that were reported under previous GAAP as assets or liabilities. 3. Apply transitional provisions of IAS 39 to all other hedging relationships.	**Previously derecognised financial assets and financial liabilities** Apply derecognition criteria prospectively from 1 January 2004. (may apply derecognition criteria retrospectively if information was available at the time of the transaction). **Hedge accounting** 1. Measure all derivatives at fair value. 2. Eliminate all deferred losses and gains arising on derivatives that were reported under previous GAAP as assets or liabilities. 3. Apply transitional provisions of IAS 39 to all other hedging relationships.
EQUITY			
Foreign currency translation reserves	1. Option to set all translation differences to zero. 2. Profit and Loss on future sales or disposals of related entity are not adjusted for differences written off prior to date of transition. 3. Classify as a separate component of equity.	1. Option to set all translation differences to zero. 2. Profit and Loss on future sales or disposals of related entity are not adjusted for differences written off prior to date of transition. 3. Classify as a separate component of equity.	1. Option to set all translation differences to zero. 2. Profit and Loss on future sales or disposals of related entity are not adjusted for differences written off prior to date of transition. 3. Classify as a separate component of equity.
Minority interest	Adjust for the effect of any adjustments to assets and liabilities of subsidiaries. Minority interests should be disclosed as part of equity in terms of IAS 27.	Adjust for the effect of any adjustments to assets and liabilities of subsidiaries. Minority interests should be disclosed as part of equity in terms of IAS 27.	N/A
NON-CURRENT LIABILITIES			
Defined benefit obligation	Provided the subsidiary did not apply IFRS before the parent company: 1. Option to recognise all cumulative unrecognised actuarial gains/losses in retained earnings at date of transition. 2. May continue to use the "corrdidor" approach in the future. 3. Must be applied consistently to all employee benefit plans.	1. Option to recognise all cumulative unrecognised actuarial gains/losses in retained earnings at date of transition. 2. May continue to use the "corrdidor" approach in the future. 3. Must be applied consistently to all employee benefit plans.	1. Option to recognise all cumulative unrecognised actuarial gains/losses in retained earnings at date of transition. 2. May continue to use the "corrdidor" approach in the future. 3. Must be applied consistently to all employee benefit plans.

Balance sheet line item	Acquired as Part of a Business Combination? – Yes: Before date of transition (or earlier selected date) – Application of IFRS 1 Appendix B	Acquired as Part of a Business Combination? – Yes: After date of transition (or earlier selected date) – Retrospective application of IFRS 3	Acquired as Part of a Business Combination? – No
	All business combinations after the earliest selected application date must be accounted for in terms of IFRS 3		
NON-CURRENT LIABILITIES (continued)			
Deferred tax liabilities	Apply IAS 12 to temporary differences arising at the date of transition on the carrying values of assets and liabilities recognised in accordance with IFRS.	Apply IAS 12 to temporary differences arising at the date of transition on the carrying values of assets and liabilities recognised in accordance with IFRS.	Apply IAS 12 to temporary differences arising at the date of transition on the carrying values of assets and liabilities recognised in accordance with IFRS.
CURRENT LIABILITIES			
Trade, other payables and provisions, short term loans	Refer to the general principles above.	Refer to the general principles above.	Refer to the general principles above.

Appendix C – Presentation and disclosure checklist

IFRS 1 includes some presentation and disclosure requirements which increase the level of disclosures in the first IFRS financial statements. IFRS 1 does not provide any exemptions from the presentation and disclosure requirements in other IFRS, however IAS 8's requirements for disclosures on changes in accounting policies do not apply in the first IFRS financial statements.

IFRS 1 reference	IFRS 1 presentation and disclosure checklist	Yes/No/N/A
	First IFRS financial statements	
36	Does the entity's first IFRS financial statements include at least **one year of comparative information** under IFRS?	
36A	If the comparative information does **not comply with IAS 32, IAS 39 or IFRS 4**: (i) Has the entity disclosed this fact together with the basis used to prepare this information under previous GAAP? (ii) Does the entity provide narrative disclosures of the nature of the main adjustments that it would need to make to comply with IAS 32, IAS 39 and IFRS 4?	
37	If the entity presents **historical summaries** of selected data for periods before the first period for which it presents full comparative information under IFRS: (i) Is this information prominently labelled as not being prepared under IFRS? (ii) Does the entity provide narrative disclosures of the nature of the main adjustments that it would need to make to comply with IFRS?	
38	Has the entity **explained how the transition** from previous GAAP to IFRS affected its reported financial position, financial performance and cash flows?	
39(a)	Does the entity's first IFRS financial statements include **reconciliations of its equity** reported under previous GAAP to its equity under IFRS for both of the following dates: (i) the date of transition to IFRS? (ii) the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP?	

IFRS 1 reference	IFRS 1 presentation and disclosure checklist	Yes/No/N/A
39(b)	Does the entity's first IFRS financial statements include **a reconciliation of the profit or loss** reported under previous GAAP for the latest period in the entity's most recent annual financial statements to its profit or loss under IFRS for the same period?	
39(c)	If the entity **recognised or reversed any impairment losses** for the first time at the date of transition, has it provided the disclosures that IAS 36 would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition?	
40	If the entity presented a cash flow statement under its previous GAAP, has it explained the **material adjustments to the cash flow statement**?	
41	If the entity became aware of errors made under previous GAAP, have the reconciliations **distinguished the correction of those errors** from changes in accounting policies?	
43	If the entity **did not present financial statements for previous periods**, has it disclosed this fact in its first IFRS financial statements?	
43A	If the entity **designated previously recognised financial assets or financial liabilities** as "at fair value through profit or loss" or as "available-for-sale", has the following disclosures been provided: (i) the fair value of any financial assets or financial liabilities designated into each category? (ii) the classification and carrying amount in the previous financial statements?	
44	If the entity used fair value in its opening IFRS balance sheet as **deemed cost for an item** of property, plant and equipment, an investment property or an intangible asset, has the entity's first IFRS financial statements disclosed, for each line item in the balance sheet: (i) the aggregate of those fair values? (ii) the aggregate adjustment to the carrying amounts reported under previous GAAP?	
	Interim financial reports under IAS 34	
45	If the entity presents an **interim financial report under IAS 34,** and it **also presented an interim financial report under previous GAAP** for the comparable interim period of the immediately preceding financial year, has it in the interim financial report for a part of the period covered by its first IFRS financial statements included the following five reconciliations of:	

IFRS 1 reference	IFRS 1 presentation and disclosure checklist	Yes/No/N/A
	Equity under previous GAAP to equity under IFRS at:	
45(b)	1. the date of transition to IFRS?	
45(a)(i)	2. the end of that comparable interim period?	
45(b)	3. the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP?	
	Profit or loss under previous GAAP to profit or loss under IFRS for the same period for:	
45(a)(ii)	4. the comparable interim period (current and year-to-date)?	
45(b)	5. the latest period in the entity's most recent annual financial statements?	
46	If the entity did not, in its most recent annual financial statements under previous GAAP, disclose **any events or transactions that are material to an understanding of the current interim period**, has it provided these disclosures in its interim financial report under IAS 34 or included a cross-reference to another published document that includes it?	
	Effective date	
47	If IFRS 1 is applied to annual periods beginning before 1 January 2004, has this fact been disclosed?	

Appendix D – 2005 stable platform of IFRS

Series	Title
Framework	
IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Cash Flow Statements
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events After the Balance Sheet Date
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 14	Segment Reporting
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions
IAS 31	Interests in Joint Ventures
IAS 32	Financial Instruments: Disclosure and Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 36	Impairment of Assets

IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IAS 41	Agriculture
IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations

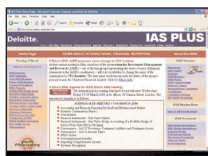
Interpretations expected to remain applicable at 1 January 2005

SIC 7	Introduction of the Euro
SIC 10	Government Assistance – No Specific Relation to Operating Activities
SIC 12	Consolidation – Special Purpose Entities
SIC 13	Jointly Controlled Entities – Non-Monetary Contributions by Venturers
SIC 15	Operating Leases – Incentives
SIC 21	Income Taxes – Recovery of Revalued Non-Depreciable Assets
SIC 25	Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders
SIC 27	Evaluating the Substance of Transactions Involving the Legal Form of a Lease
SIC 29	Disclosure – Service Concession Arrangements
SIC 31	Revenue – Barter Transactions Involving Advertising Services
SIC 32	Intangible Assets – Web Site Costs
IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities

Notes

Notes

Deloitte Touche Tohmatsu has a range of tools and publications to assist companies in implementing and reporting under International Financial Reporting Standards. These include:

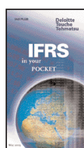


www.iasplus.com

Updated daily, iasplus.com is your one-stop shop for information related to IFRS.

Model IFRS Financial Statements

Published annually, it provides practical guidance for the application of IFRS in preparing financial statements.



IFRS In Your Pocket

Published in English, Finnish, French, Polish and Spanish, IFRS In Your Pocket provides summaries of each IFRS.

IASPlus Newsletter

Published quarterly in three editions: Asia-Pacific, Europe-Africa, United Kingdom. Plus occasional special editions.

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